

OFFICE OF RAIL AND ROAD  
TRANSCRIPT OF ECML INDUSTRY HEARING  
HELD ON  
4<sup>TH</sup> MARCH 2016

PERSONS PRESENT:

**Office of Rail and Road**

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1 THE CHAIR:

2 Good morning. Thank you for coming. Welcome to the Office of Rail  
3 and Road. My name is John Larkinson and I'm the Director of Railway  
4 Markets and Economics, and I'll be chairing today's meeting.

5 With me on the panel are Juliet Lazarus, our Director of Legal  
6 Services; Chris Hemsley, our Deputy Director of Markets and  
7 Competition; Emily Bulman, our Head of Transport Economics; and  
8 Rob Plaskitt, Head of Access and Licensing.

9 We're joined by Mick Donovan, who is our Operations Advisor;  
10 Chris Judge and Jon Clyne from our consultants, CH2M Hill, and  
11 John Segal from Systra, the auditors. Other members of the case  
12 team - David Reed, Joe Quill and Liz Thornhill - are also in the room.

13 Around the table we have representatives of the applicants,  
14 who are Alliance, Virgin Trains East Coast and FirstGroup. And we  
15 also have representatives from Network Rail and the DfT.

16 Representatives of other stakeholders, including passenger and  
17 freight operators on the route are also present.

18 A transcript is going to be taken of what's said today. Can I ask  
19 you when you speak to please give your name and your organisation  
20 to help the stenographer.

21 The transcript will be prepared as quickly as possible and a  
22 draft will be sent to those who speak. You will be able to propose  
23 amendments but without changing the substance of what you have  
24 said, and the final transcript will be published on our website.

25 The acoustics in this room are not very good, so we have got a  
26 sound system. In addition to the table microphones we've got a  
27 couple of roving microphones, so if you're not in front of a table  
28 microphone please wait for one of the roving microphones to be  
29 passed to you before you speak.

30 The purpose of today is to help ensure that we have the  
31 information we need to make decisions about the proposed services,  
32 in line with our duties. But we're not going to be taking any decisions  
33 today. This is one part of the overall process which will assist us in  
34 making a recommendation to our board, who will take the final  
35 decision on these applications.

36 It's important that our decision is properly informed by your  
37 views. This meeting is a practical opportunity for the parties to  
38 participate in discussion of the key points. With this in mind, given the  
39 number of participants there's a necessary degree of formality needed  
40 to ensure that everyone is able to make a fair contribution, and we'll try  
41 to keep this to a minimum.

42 This hearing is part of the decision-making process, and my  
43 legal colleague, Juliet, is here to ensure that due legal process is  
44 followed.

45 In the interests of time, given the number of people here, please  
46 could you try to keep your contributions focused on the most  
47 significant issues? We will not have time today for you to repeat all the  
detailed points you already made to us, but they will be picked up as

1 part of the consideration process.

2 In terms of structure, this morning we're going to start by  
3 discussing capacity, and then we're going to turn the economic  
4 analysis of the applications. We'll discuss demand modelling in our  
5 session before lunch, and following lunch we'll discuss the impacts on  
6 the parties and further issues, including the economic appraisal.

7 I'll introduce each issue and we'll begin the questioning, and  
8 stakeholders will have the opportunity to ask questions or make  
9 comments through me. I would ask that you do not interrupt each  
10 other and that we try and keep things brief and to the point.

11 At the end of each session I'll summarise any action points and  
12 at the end of the day we'll summarise the next steps in light of what  
13 we've heard.

14 Before we continue I'm going to pause there and ask if there  
15 are any questions about the process today before we make a start on  
16 capacity. No? Okay. Thank you.

17 In that case let's start on capacity, and I'm going to hand over to  
18 Rob Plaskitt to set out our current understanding of capacity issues.

19  
20 ORR:

21 Thanks, John. Good morning, everyone. To start off this section I  
22 think we should recognise the question of what capacity is or will be  
23 available, and when it will be available, is rather complicated, with  
24 rolling stock choices, service patterns, infrastructure works, power  
25 supply issues, and other things all affecting the answer.

26 So we want to start by recapping where we think we are on  
27 capacity and give everyone an opportunity to comment.

28 We'll start by setting out our thinking on the southern end of the  
29 route and then pause for Network Rail and then everyone else to  
30 comment. Then we will come back and pick up our thinking on the  
31 northern end of the route. And again, we'll pause and let Network Rail  
32 and others react. And then finally for this session I'll say something  
33 very brief about how that capacity might be used, and I'll pick up DfT's  
34 recent comments about the future of the ECML connectivity fund. And  
35 again, there'll be a chance to react and comment.

36 So picking up the south end first, and looking at services out of  
37 King's Cross. We understand VTEC currently uses around five  
38 off-peak paths an hour, open access operators First Hull Trains and  
39 Grand Central share something around one path an hour, making a  
40 total of six.

41 Our current best view is that capacity for an additional off-peak  
42 path every other hour out of King's Cross is probably available today.  
43 We think one further additional off-peak path per hour out of  
44 King's Cross should be available from the May 2021 timetable,  
45 assuming the infrastructure works at Werrington and Woodwalton are  
46 completed, in line with Network Rail's enhancement delivery plan.

47 When I say 'Enhancement Delivery Plan' I'm referring to the  
version that Network Rail has prepared that reflects the Hendy Review

1 conclusions. We spoke about this a little, some of us, before  
2 Christmas.

3 A further half path per hour off-peak, we think, may be available  
4 beyond this point, bringing the total capacity up to eight paths per off-  
5 peak hour out of King's Cross, but we would want to better understand  
6 the risks to connectivity and freight before that final half path of  
7 capacity was used. For example, we'd want to be clear what an eighth  
8 off-peak LDHS train out of King's Cross every hour would mean for  
9 reduced connectivity at places such as Stevenage or reduced capacity  
10 for heavier freight that would want to use Welwyn.

11 Just on Welwyn, we've noted Network Rail's advice that the  
12 VTEC and TSGN franchises specify a quantum of services that may  
13 not fit over the viaduct in one particular hour. We think it's sensible  
14 stakeholders have started thinking about how that can be resolved.

15 But our view is that that issue does not need to be, and  
16 probably cannot be, settled before we decide on these applications.  
17 So having a clear answer on that is not on our critical path.

18 I think those are the key points I wanted to make about our  
19 thinking on the King's Cross end of the route, so I'll just pause there,  
20 and invite, to start off with, Network Rail to comment. Is there anything  
21 in that you would like to comment on, or disagree with, or are surprised  
22 by or think we've missed out?  
23

24 NETWORK RAIL: We've got nothing further to add. We agree with your statement so  
25 far.

26  
27 THE CHAIR: Okay - that's helpful, thank you. Now we will open it up then to the  
28 applicants, and then DfT. Let's start with the applicants first. Is there  
29 anything anybody wanted to comment on on what Rob's just said?  
30

31 VTEC: We agree with some of what Rob just said. We were surprised to hear  
32 you say that there was an extra half a path an hour available now. I  
33 think that's new information to us. Our view is the route is pretty full at  
34 the moment, and bearing in mind things like freight, which often don't  
35 get discussed at this sort of meeting - you know, it needs extra  
36 capacity before we can fit any more trains on reliably at this stage. I  
37 think we had recognised the extra one path at May 2021, bringing it up  
38 to seven, possibly seven and a half with compromises, and I think we'd  
39 supported your comment on the eighth - going from seven and a half  
40 to eight - as a possibility, only a possibility, and it needs to be fully  
41 understood in terms of all the compromises that would entail and any  
42 impact on performance.  
43

44 THE CHAIR: Okay. So your main query is around the extra half a path.

45  
46 VTEC: The extra half a path now is the biggest issue for us, I think, that we  
47 don't recognise.

1  
2 THE CHAIR: Okay.  
3  
4 ALLIANCE: Yes, just to clarify, is May 2021 now the date for the additional eighth  
5 path, then?  
6  
7 ORR: I said May 2021 because it was the first timetable after the end of  
8 December 2020, which is the date in the draft Enhancement Delivery  
9 Plan for the Woodwalton and Werrington schemes.  
10  
11 ALLIANCE: The reason I ask that is that that's a later date than everybody's plans  
12 for additional services, so it actually will be delaying even the start of  
13 the additional franchise services.  
14  
15 ORR: Well, we're not saying capacity couldn't be available before May 2021.  
16 ALLIANCE: Okay. I have one further point to make, and that is about current open  
17 access services. The common assumption has been made throughout  
18 the process that only one path is currently used by open access. That  
19 actually is not correct. There are 16 paths today which are in each  
20 direction and they currently are spread over the maximum of 14 hours  
21 a day, which realistically is the maximum that can be achieved to get a  
22 sensible service. And one of those hours is basically barred because  
23 it's a high peak hour in each direction. So it's 16 paths in a maximum  
24 of 13 hours, which is around one and a quarter paths. So it is more  
25 than one. It's less than one and a half but it's more than one.  
26  
27 ORR: Yes. There's certainly at least one hour where there are two quite  
28 close together arriving in London. I concur with that.  
29  
30 THE CHAIR: Anything else from the applicants? No. Okay. I'll just ask whether  
31 DfT wanted to come in at all.  
32  
33 DFT: I just want to echo the concerns that Andy was expressing about, and  
34 the need to clarify connectivity and the ability of other operators,  
35 including freight, to fit in amongst the mix of services, and concerns  
36 around if something happens. The nearer you get towards even seven  
37 and a half, never mind eight, the more difficulty it may be.  
38  
39 DFT: So we note your points around needing to understand risks to  
40 connectivity and freight. We need to understand risks to performance  
41 as well. We think that's also very important. The current performance  
42 of the line is not indicative of there being very substantial amounts of  
43 spare capacity at the moment, and we would be concerned about that  
44 trade off as well.  
45  
46 THE CHAIR: Thank you. Any other points before we move on to the northern end?  
47

1 FIRSTGROUP: I think the only thing we would add to that in terms of the point that  
2 Simon Smith has made about performance is that I think previously as  
3 part of this whole application we've provided evidence as to how  
4 performance should be unaffected as a result of the applications that  
5 are being discussed. We provided that both in writing and at the  
6 previous meeting in October there was a discussion around  
7 performance.  
8

9 THE CHAIR: Okay, thank you. Any other points?  
10

11 VTEC: If we're covering performance now then I'd like to just say more about  
12 that. We have very strong concerns about performance, both  
13 increasing - or particularly around this seven and a half, eight trains an  
14 hour. There hasn't been any sort of robust recent work done by  
15 Network Rail, as far as we're aware, on performance. The best  
16 estimate there is the figure that Fiona put in the letter of May 2015,  
17 which was 1.8 to 2 per cent impact on PPM without appropriate  
18 mitigations, which at that stage really hadn't been identified.  
19 We've done a quick look - effectively a back of the envelope  
20 calculation - and we reckon that's worth about £160 million in lost  
21 revenue to the franchise over 10 years. That can't be ignored. That's  
22 a big number. So we can't just blindly go into approving paths without  
23 understanding that 1.8 to 2 per cent better than we do today, I think, or  
24 making allowance for it.  
25

26 THE CHAIR: Okay. So you're reinforcing the points you've previously made about  
27 performance?  
28

29 VTEC: Yes  
30

31 THE CHAIR: Okay, thank you. I'm going to move us on now to the northern end.  
32

33 ORR: So, turning to the northern end of the route then. The latest power  
34 supply analysis that Network Rail has produced was discussed last  
35 week in York. Several people here will have been at that meeting.  
36 We understand from that that Network Rail has identified work,  
37 such as upgrading various feeder stations, will be needed around  
38 Doncaster and further north to meet any increase in electric load  
39 beyond today's levels. Works in the Doncaster area, we understand,  
40 may be delivered around the end of December 2017 on current plans,  
41 but it seems unlikely the other necessary power supply enhancements  
42 will be completed much before the end of 2020, and that is subject to  
43 Network Rail working out what exactly it needs to do, and ought to do,  
44 and securing CP6 funding to do that work.  
45 We think the Northallerton freight loops listed in Network Rail's  
46 current Enhancement Delivery Plan, the draft Plan, for completion in  
47 March 2019, are needed to protect freight particularly if extra

1 passenger trains are to run between York and Newcastle. And looking  
2 at Edinburgh we agree with Network Rail's view that no more than two  
3 and a half London to Edinburgh trains per hour could run without  
4 unduly impacting freight and local connectivity. So those I think are  
5 the two or three key points we want to make on the north end of the  
6 route.

7 Network Rail, how does that sound to you?  
8

9 NETWORK RAIL: I'll say the same thing as I said last time: that we agree with your  
10 summary of the situation and we don't have anything to add to that.

11  
12 THE CHAIR: Okay. Thank you. Let's follow the same format, then, of just going  
13 first to the applicants, then to DfT, and then opening up to anybody  
14 who wants to make a comment.  
15

16 VTEC: There are just a couple of things I'd just like to say. I note your  
17 comment in terms of the northern freight loops. I think it's just worth  
18 adding that in the meeting earlier this week in York Network Rail  
19 indicated that the northern freight loops may actually be delayed to  
20 early CP6 rather than completed in March 2019, and the timescales  
21 are under review and not yet firmed up.

22 The second point is, noting your comments about London -  
23 Edinburgh trains, clearly since our last meeting here the franchise  
24 award for TransPennine and Northern have been made, the franchise  
25 TransPennine being awarded to FirstGroup, and the proposal within  
26 that include additional services between York and Edinburgh, and I  
27 suggest that that may need to be thought about as part of this process  
28 now, because clearly that is a new development since this process  
29 started, and it clearly has an impact on the capacity demand north of  
30 York.  
31

32 THE CHAIR: Can I just ask you, David - that first comment you made about the  
33 possible change in the date, when did you say that possible change  
34 had been indicated? The power supply meeting?  
35

36 VTEC: It was a stakeholder group. Ian was there - a stakeholder group  
37 looking at the East Coast Main Line Connectivity Fund where we had  
38 an update on the various schemes. The freight loops are part of the  
39 Connectivity Fund output. Network Rail indicated that whilst they're  
40 hoping to still deliver the schemes within CP5, there is a possibility that  
41 the freight link project may slip into early CP6.  
42

43 THE CHAIR: Graham, could you comment on that?  
44

45 NETWORK RAIL: I think what's David's referring to is the piece of ongoing  
46 communication and information sharing on where we are with projects.  
47 David has articulated we share the risks. The dates in the delivery



1 plan are indicative, and we've got more work to do to demonstrate how  
2 we get to there.  
3

4 THE CHAIR: Thank you.  
5

6 ALLIANCE: I would agree with what David has said about the freight loops. That's  
7 where we were, and Graham has just highlighted the position. There's  
8 a couple of further things here. First of all the award for TransPennine  
9 and Northern really are not part of the process here. This is to deal  
10 with the applications that you have. I think that's quite important.  
11 The second one is that in view of the position that the DfT made  
12 clear about the possible withdrawal of funding for the CP5 schemes,  
13 bearing in mind that the electricity supply is likely to tip into CP6 can I  
14 have a view from the DfT as to whether or not the threat of withholding  
15 further investment on the route will accompany a possible award of an  
16 open access service on this route?  
17

18 THE CHAIR: I'll ask DfT to come back on that with any points DfT have in general  
19 on this. Just before we get there I'll just see if there are any other  
20 points from applicants?  
21

22 VTEC: I think there's just this general concern about, clearly, exactly when  
23 either of the infrastructure schemes are to be delivered, as both are  
24 required in order to release the additional capacity, and to pick up on  
25 Graham's point, the dates that we've all seen are simply indicative. So  
26 there's this fundamental uncertainty prevailing throughout.  
27

28 THE CHAIR: Okay. Thank you.  
29

30 VTEC: One further point from me concerning Leeds - I'm assuming that Leeds  
31 counts as the north. I think we're currently not clear about the capacity  
32 between Hambleton Junction and East Leeds for extra services via  
33 East Leeds Parkway, various people have said that there is or isn't  
34 capacity for an InterCity type operation and I think that needs to be  
35 understood fully before a decision can be made that involves trains  
36 using that route.  
37

38 ALLIANCE: On that point about capacity between Hambleton Junction and Leeds,  
39 Alliance is in discussion with Network Rail at the moment about ways  
40 in which we can help increase capacity on that section of route if that  
41 is needed. Those discussions are ongoing and we will be talking to  
42 the ORR separately about that. It's a fairly recent development. We're  
43 reopening discussions that we had some time ago.  
44

45 THE CHAIR: Okay. Thank you. Can I ask if DfT want to come in at this point?  
46 Generally and also in terms of answering Ian's point.  
47

1 DFT: We have nothing further to add on the basic capacity issues. On the  
2 point about CP6, I think it's way too early at this stage to comment on  
3 priorities for CP6. There will clearly be a number of competing  
4 priorities, with a number of schemes having been delayed from CP5,  
5 but it is too early at this stage to comment. In general the Department,  
6 when undertaking analysis of the case for different enhancement  
7 schemes, as we've set out we'd look at the benefit to cost ratio of  
8 those schemes. If the schemes facilitate the introduction of highly  
9 abstractive open access services then it is likely that the cost elements  
10 of the benefit to cost calculation, that is the cost to government  
11 element, will be quite high and that will affect that analysis.  
12

13 THE CHAIR: Would anyone not at the table like to come in at this point?  
14

15 FTPE: Just to provide a bit of context to the points that have already been  
16 made about franchise award. Over the next seven years we will be  
17 seeing quite major changes in our timetable that have been committed  
18 to DfT as part of the new FirstGroup franchise. We'll see an  
19 introduction of high performance rolling stock, and as part of that the  
20 intention is to apply for additional access on the East Coast Main Line  
21 in two phases, so both north of York to Newcastle initially, and then  
22 further to Edinburgh. So as has been noted, whilst not directly  
23 relevant to the determination it's probably quite an important context to  
24 be aware of. Those applications will be submitted for industry  
25 consultation imminently. Thank you.  
26

27 THE CHAIR: Okay. Thank you.  
28

29 ORR: There were just two other points we wanted to pick up in this section,  
30 one about the Hendy consultation first of all. The DfT said in its Hendy  
31 consultation, which I think is still open if anyone hasn't replied yet, that  
32 its decisions about the connectivity fund might depend on our East  
33 Coast access decisions. Everyone, certainly the applicants, should  
34 have seen we have exchanged letters with DfT, starting to explore  
35 what that statement means.  
36

37 The current position is that we think the value for money  
38 concerns that DfT have raised are relevant to our duties, but we are  
39 unclear how much weight we can reasonably give them in this kind of  
40 decision-making process in the absence of any information about: the  
41 assumptions that were originally made about value for money of the  
42 fund or individual projects within it, details of the analysis, how the  
43 analysis would change depending on the decisions we might make,  
44 and an understanding of how material those changes might be for  
45 value for money.

46 So we've asked DfT to share whatever analysis and thoughts it  
47 has on those points, and we've asked for a reply by 15 March. That  
letter only went out yesterday. We'll be copying it around everyone in

1 the usual way. We didn't want to bombard everyone with too many  
2 new bits of information just before today.

3 So that's where we stand on that issue which Ian referenced a  
4 moment ago.

5  
6 THE CHAIR: Can I just pause on that point? I don't know if DfT wanted to say  
7 anything more at this stage or not.

8  
9 DFT: I don't think there's anything more that we can say on that at this  
10 stage, other than what was set out in our letter from 19 February,  
11 which I assume that you and the applicants have seen, but to reiterate  
12 the point the original condition for the fund should be a BCR threshold  
13 of 1.5 for individual projects. That BCR threshold and the overall case  
14 of the fund itself was predicated on the assumption that the East Coast  
15 franchisee would use the additional capacity. The BCR is likely to be  
16 significantly impacted if the capacity was used by an open access  
17 operator, and therefore that threshold of 1.5 may well not be reached.

18  
19 THE CHAIR: Thank you.

20  
21 ALLIANCE: I'll be very keen to see the evidence about the position for the  
22 agreement for this fund, going all the way back to well into CP4 about  
23 the BCR. It's the first I've heard about it, and DfT are starting to use it  
24 now.

25 This fund was approved as part of the regulatory settlement as  
26 far as I'm aware, and it would appear to me that the DfT are now trying  
27 to retrospectively review a regulatory settlement for something that just  
28 doesn't suit.

29 Now, in respect of a BCR in relation to investments via those  
30 approvals in the ORR, then I don't quite see how the DfT can view this  
31 as anything other than state aid, and it's certainly an area that we'll be  
32 responding back to you on in relation to the consultation that's open at  
33 the moment.

34 But the fact is that, going all the way back to the original  
35 meetings when this was fund was first approved, the talk then was of  
36 increasing the route availability from six to seven paths, and it is only  
37 Alliance that continued to badger and pester, as I'm sure my  
38 colleagues at Network Rail will agree, to say that there's already seven  
39 and therefore you shouldn't be spending any money at all if it's only  
40 seven that you want.

41 And eventually we've got to the conclusion - which I think  
42 you've come to as well, which by 2021 there will be eight, which is  
43 where we expect it to be.

44 At that time, at those meetings - and they're all minuted - the  
45 DfT said they wanted six paths on the route - not six and a half or  
46 seven - six paths on the route and that one of the issues in relation to  
47 this investment as well is to deliver the six paths they will need to

1 make these investments anyway.

2 I regard the letters from the DfT - and I'm happy to put it into  
3 print today - as nothing more than blackmail of the independent  
4 regulator. I'd like to make the point clearly today, that we're not happy  
5 about it, it won't finish here and we'll continue to respond in the way  
6 that we think, legally, is the right way to respond.

7  
8 THE CHAIR: Thank you.

9  
10 ALLIANCE: Can I add as well, with the Connectivity Fund we'd like to note that the  
11 DfT has had ample option to protect its interests here. It could have  
12 looked at using the rebate mechanism. It could have looked at  
13 agreements with operators upfront. It could have looked at access  
14 options, could have looked at protecting loss. It could have looked at  
15 the levy. All these things we've raised with the DfT, and I'd like to  
16 know from the DfT, instead of it whinging about impact on Secretary of  
17 State's funds, what it's actually done to try and avoid putting taxpayers'  
18 funds at risk.

19 Because at the minute all it's doing is saying it's getting the  
20 taxpayer to back up the risk. It's requiring taxpayer investment in the  
21 network. What we are saying firmly is "You didn't need to do that.  
22 There's an alternative mechanism. We will quite happily pay our way."  
23 But we're not being allowed to do that. I think that's an important  
24 point, where open access are actually wanting to pay a bit more to  
25 contribute and there is a way forward through existing mechanisms.  
26 We would like to do that. The DfT hasn't made use of those.

27  
28 THE CHAIR: I'll take some more points before giving people an opportunity to come  
29 back. Thank you.

30  
31 FIRSTGROUP: I think the only point we have around the East Coast Connectivity  
32 Fund is in a letter we sent to the ORR last week, which I believe was  
33 copied to parties around the room.

34 And that goes to the point that Ian already made that the  
35 investment is required to unlock the capacity that's required for the  
36 franchise, and in doing so - in unlocking the capacity and spending  
37 that money to unlock the capacity it - by its very nature, unlocks more  
38 capacity, and Ian's already pointed out that I think everyone's come to  
39 the conclusion that there will be eight paths available.

40 Now, what hasn't been picked up so far in terms of some of the  
41 points that have been made is that if a path is created and the  
42 franchisee runs what the business case was for the original franchise,  
43 which is the six plus the existing paths - the ones we talked about from  
44 Hull Trains and Grand Central, and an additional path that's available,  
45 and open access operators use that - then the overall economic  
46 benefit is likely to be higher than was originally considered in the  
47 business case. The total economic benefit of having both paths

1 operating is likely to be higher as a result of the investments spent.  
2 And when I say 'total economic benefit' I mean all economic benefit,  
3 not just benefit to the DfT.  
4

5 THE CHAIR: Okay. Thank you. Any other points on that before I see if DfT want to  
6 come back?  
7

8 HULL TRAINS: I have a big concern about the regulatory settlement and what is  
9 funded for enhancements, i.e. the Connectivity Fund. We're of the  
10 view that unless that investment is predicated by a track access  
11 application of some sort to use that investment for a particular  
12 purpose, then the result of that investment is free for everybody to bid  
13 into.

14 It is the inability to join the dots up - and if you're putting money  
15 forward, if you're making an investment case for new raiing stock or a  
16 new franchise and you don't put the rights with that case then it's not  
17 following the industry procedure and it's giving other parties false  
18 expectations, through the regulatory settlement, of what they can  
19 actually use in terms of the network to run existing services better or  
20 new services in the future.

21 And I really would urge that the DfT actually starts to use the  
22 industry mechanisms rather than coming late to the party and trying to  
23 retrospectively alter things to suit a purpose which should have been  
24 more thoroughly thought through in the first place.  
25

26 THE CHAIR: Thank you. Does the DfT want to come back on any of those points?  
27

28 DFT: I'm not sure there's much for us to add on that. We obviously  
29 welcome Alliance's apparent willingness to pay its way. I think the  
30 DfT's concerns about open access applications would be much  
31 reduced if open access operators did pay their way, but under our  
32 current charging structure - which is a matter for ORR, not for us - they  
33 don't.  
34

35 THE CHAIR: Just to check, were you referring to something specific then with that  
36 comment, Jonathan?  
37

38 ALLIANCE: Yes. There are existing mechanisms including access options, and  
39 with regard to the connectivity problem, what DfT could have done  
40 there is actually engage with operators. The reason [inaudible] to do  
41 that under the organised policy up from negotiations where you can  
42 say 'Pay your way.'

43 But actually the DfT is not taking advantage of existing  
44 mechanisms. All it has done is sit there and say 'open access is going  
45 to abstract.' But actually we want to talk to the DfT and we want to  
46 look at paying our way. We're quite happy to do it.  
47

The other thing is, in relation to the levy which is in the directive

1 but not UK law, we've been pushing for payment of a levy, but the DfT  
2 have sat by and not implemented the levy which would allow us to pay  
3 towards provision of PSO services, and that would reduce the burden  
4 on the taxpayer for funding the rail network.

5 The DfT seems to want the taxpayer to continue to fund the rail  
6 network, and that is wrong. And one other thing I'd just like to point in  
7 relation to DfT's statement saying that in relation to investments being  
8 at risk, an important point here is that we are coming along with  
9 significant third-party non-taxpayer funded investment into the network  
10 in infrastructure and in rolling stock in two applications.

11 We can say the same. We can say 'If we don't get the access  
12 rights that's at risk as well.' So I don't think that's a valid point that the  
13 DfT are making.

14  
15 THE CHAIR: Okay. Thank you.

16  
17 ALLIANCE: Can I come back to - I know this meeting is not about the charging  
18 structure, but the DfT have made a point about the charging. Just to  
19 be clear, the charging structure at the moment is based on moderation  
20 of competition for entry to the market by open access. If open access  
21 is allowed free head-to-head competition with the franchise, then you  
22 can look at a different charging mechanism. The current charging  
23 mechanism is based on two different markets for paths and for getting  
24 paths granted on the network. So it's wrong to say that open access is  
25 not paying its way.

26  
27 THE CHAIR: Okay. Thank you.

28  
29 FIRSTGROUP: Just an observation in that some of the submissions that are being  
30 made seem to be getting close to a submission that the decision  
31 should be made on the basis of a structure which may or may not  
32 come into place in the future. Obviously we do have a legislative  
33 regulatory regime for open access, or if necessary for tying paths to a  
34 particularly regulatory settlement then under submission.

35 If that is not done, then obviously there is the regulatory  
36 balancing exercise to do. But our submission would be it has to be  
37 under the rules that are there now and not on a future charging  
38 structure.

39  
40 THE CHAIR: That's right. Yes.

41  
42 ALLIANCE: Can I just add something? Just at the time when we've got the Shaw  
43 Report, which is looking at ways to bring in third-party investment into  
44 the network, the DfT's position which is basically threatening to  
45 withdraw funding, what sort of message does that send in terms of  
46 confidence for anybody who might want to look at investing in the  
47 network? Because if I - even completely [inaudible] denying it. I think

1 that the DfT needs to take that into account, that when they are  
2 coming along, saying that they can threaten to withdraw funding, it  
3 sends out the wrong message to the industry.  
4

5 THE CHAIR: Okay. Thank you.  
6

7 ORR: So just to wrap up on this section then, we talked a little bit earlier  
8 about the north and south ends of the route and our current views on  
9 capacity. Just looking at what might be done with that and to  
10 summarise the applications that we are considering, additional  
11 capacity could be allocated, we think, to subsets of services taken  
12 from: up to one additional hourly path for VTEC's additional  
13 trains to Edinburgh; half an hourly path for VTEC's Middlesbrough  
14 service; up to half an hourly path for First Edinburgh; one for Alliance  
15 Edinburgh and up to one for the Alliance Cleethorpes / West Yorkshire  
16 proposal; any additional capacity could be allocated to subsets made  
17 up from these services.

18 That was the last thing we wanted to say in this section. I don't  
19 think that's a controversial statement but I'll just check in case anyone  
20 disagrees or thinks I've missed something out.  
21

22 VTEC: I just think the point on the north of the route - the north of the route  
23 still requires CP6 funding.  
24

25 ORR: Yes - the idea that one could take subsets of those choices and put  
26 them together and approve them is all subject to the long list of  
27 caveats we discussed earlier.  
28

29 ALLIANCE: Just one quick question. At the last hearing I raised the issue about  
30 access to Middlesbrough, and we were talking earlier about capacity. I  
31 know there was some follow up. I think Network Rail did take the  
32 issue away and have a look at whether it would be possible to run an  
33 intercity or IEP train into Middlesbrough. Has that been looked at? If  
34 you're still looking at the Middlesbrough application then is it possible  
35 to run an IEP into Middlesbrough? Does Network Rail have a view on  
36 that?  
37

38 NETWORK RAIL: We haven't looked at this in any further detail at this stage, so we can't  
39 comment on it.  
40

41 THE CHAIR: Okay.  
42

43 ALLIANCE: Rob just said that the Alliance West Yorkshire application was, in  
44 round figures, one path per hour. Actually it's significantly less than  
45 that. It's nine trains a day, which is slightly more than half but  
46 significantly less than one. And I know we're talking in broad figures  
47 about whole paths and half paths, but bear that in mind, that it isn't a

1 whole path.

2  
3 ORR: Yes, we accept that and I think Chris made a similar point earlier about  
4 the dangers of rounding. We are alert to that.

5  
6 THE CHAIR: Yes. That's a good point. That covers all we wanted to cover on  
7 capacity, unless anybody else has got any other points. So let's now  
8 move on to talk about the different aspects of the economic appraisal.  
9 We're going to start by focusing on the set of issues around demand  
10 modelling before lunch, then after lunch go onto the impact on parties,  
11 so for example the impact on the Secretary of State's funds and on  
12 other open access operators, and then we'll move onto other aspects  
13 of the economic appraisal: for example the treatment of infrastructure  
14 costs and sunk costs.

15  
16 ORR: Just to set out a bit of context so that we can try and work through the  
17 issues here in a simple sequence. I think that it's clear that central to  
18 the evidence that we have on revenue and economic impacts that  
19 we're going to use for our decision making is the CH2M report.

20 As you know, we've commissioned that report. It's been  
21 circulated and it has been accompanied by Systra's work to audit  
22 CH2M Hill's analysis. Separate to that, DfT has circulated an updated  
23 version of the SDG report that it has commissioned, and there was a  
24 helpful note there as well which responded to the views that SDG and  
25 DfT had received on an earlier draft.

26 So there's a lot of material here but I think it's really important  
27 that we try and progress on the basis that those reports have been  
28 widely reviewed, have been read by parties, and that there is no need  
29 necessarily here to summarise the detail of the approaches that each  
30 of those individual reports have taken.

31 Further, I think it's worth noting that quite a large number of  
32 points have been made about the CH2M report. I think it's helpful that  
33 you have set those out in writing, and we will review and reach a view  
34 on those points.

35 We do not intend to discuss each individual one of those points  
36 at this meeting. There obviously is not the time to do that and I don't  
37 think it would make the best use of the time we have. Rather, can we  
38 please focus on those issues where we think that discussion in this  
39 forum could add significantly to the available evidence?

40 I would therefore ask all parties to avoid simply repeating the  
41 material that is set out clearly in their reports or that has been  
42 previously submitted to ORR in writing.

43 Reflecting this, we propose to structure the session around a  
44 subset of issues. As I've noted, these issues are the ones where we  
45 think that discussion and debate here today in this forum could add  
46 significantly to the available evidence base.

47 So we're going to structure the discussion around a list of



1 issues as follows, which reflects the sequencing in the CH2M Hill  
2 report annexes.

3 We're going to start off with Annex B, which is the MOIRA  
4 modelling. In particular here we're going to talk about the options that  
5 have been modelled, and our intention here is to pick up some issues  
6 relating to the specification of the FirstGroup timetable, and some  
7 characteristics of the FirstGroup service in that section. So we will turn  
8 to that one first.

9 We will then turn to Annex C, which is the fares overlay. That  
10 includes the issue of competitive response, and we expect to spend a  
11 reasonable amount of time on that point.

12 We'll then turn to Annex D, which is the competition overlay,  
13 and then Annex E, which is the gravity model, before finally turning to  
14 Annex F, which is the crowding model. And our intention here is to  
15 talk about some of the technical issues associated with some of the  
16 proposed services, and there is also the related issue of crowding for  
17 Middlesbrough.

18 So if we follow that structure we think that also provides us with  
19 an opportunity to discuss the underlying reasons for the differences  
20 between the CH2M and SDG reports, so we'll pick those up as we go  
21 through. And obviously then there's an opportunity for more general  
22 comments after we've gone through that.

23 So if people are with me so far, I think that means that we  
24 should turn to annex B. So that's the Moira modelling and options.  
25 And I'll start off with a bit of context and a couple of questions.

26  
27 ALLIANCE:

28 I'd just like to make a point. I'm not quite sure what relevance the  
29 report from one of the interested parties – the SDG report - is, and  
30 whether it's more relevant than the report from AECOM, which is our  
31 work, and the report from FirstGroup in relation to their work.

32 It really is a concern for me. I made that quite clear I think in  
33 our response to SDG. It was of interest, but it's their work, so why are  
34 we interested in their work? And it is a concern because you seem to  
35 be taking that into account, and we're going to discuss it publicly, but  
36 the work that the others have done, which you wouldn't normally put in  
37 a public domain anyway, we can't discuss. So I think the SDG report  
38 is an irrelevance in relation to what's going on here today, and I'm  
39 quite disappointed if you do end up actually giving it any credence  
40 whatsoever in this forum.

41 THE CHAIR:

42 Well, the report has been tabled and I do think it's quite important that  
43 we understand the differences between the different reports. But  
44 there's nothing stopping everybody chipping in with the pieces of  
45 information or evidence that they think are particularly relevant in  
46 addition, so we're not stopping anybody chipping in. But I think it's  
47 quite important that we do explore the differences.

1 ALLIANCE: I mean, you would expect me to disagree with that. As I said, this is a  
2 report from a group that's got a serious interest in what happens here,  
3 as we made quite clear; as indeed did FirstGroup in relation to their  
4 input. So it's a biased report. It's clearly a biased report, and as a  
5 result I just cannot see that it has any relevance, and I actually think  
6 it's a real issue if it's discussed here today as being relevant to an  
7 independent decision.  
8

9 THE CHAIR: Well, it's a piece of analysis, and ultimately our board has to decide  
10 what weight they place on different pieces of analysis. But given the  
11 purpose of the hearing, which is trying to shed more light on the  
12 issues, I do think it's relevant. But I would urge you at any stage, if  
13 you've got issues you want to raise, then - you will do.  
14

15 ALLIANCE: I understand your position, John, and you're Chair. I fully understand  
16 that. But we have been consistent. Our response to the report was  
17 consistent in what we said. When we sent in our comments we made  
18 it quite clear we were just sending it to you, not for any internal  
19 discussion.  
20 So, we may input at any time. But I'd just like to be recorded as  
21 saying our real concern that this biased report is being used in this  
22 forum.  
23

24 THE CHAIR: Okay. Thank you.  
25

26 DFT: We clearly disagree with that characterisation of the report as biased.  
27 What we tried to do is in the interest of constructive engagement with  
28 this process, to try to assist the ORR with its decision-making, not only  
29 prepared a detailed piece of analysis, but also shared that detailed  
30 piece of analysis on an open basis with all of the applicants.  
31 We then prepared and provided a further note which reflects the  
32 points that have been raised by the applicants. We think it is an  
33 incredibly important for the ORR to consider that report. I think that  
34 we've acted in an entirely procedurally proper way, and in a  
35 constructive way and an open way. So we want to also put that on the  
36 record alongside Ian's comments.  
37

38 ALLIANCE: Okay. If this was a fully inclusive report we would have been  
39 consulted prior to the preparation of the report, not after the report, as  
40 indeed would our colleagues at FirstGroup. So, I'm sorry, I don't  
41 accept that you've actually done something that's independent and  
42 fully inclusive.  
43

44 THE CHAIR: Okay, I think we're going to note the disagreement on that. Thank you  
45 both. But I am going to stick to the structure that we have set out, and  
46 we will move on now to the MOIRA model.  
47

1 ORR:

2 Okay, so this is focused on the issues covered in Annex B of the  
3 CH2M report, so MOIRA modelling and the options.

4 So I will repeat the comment I've made; there are obviously a  
5 lot of comments on the MOIRA modelling and we don't propose to go  
6 through those all here. But there is a particular issue related to the  
7 FirstGroup application and the options that have been modelled that  
8 we'd like to pick up.

9 As you're familiar, we've been considering the issue of the  
10 overtake manoeuvre and the modelling of that, and the extent to which  
11 we think that is likely. Our current team view is that we think that is  
12 unlikely to be timetabled in practice. Reflecting this, CH2M have  
13 tested a further option, which is number 15 in their report, that  
14 removed that overtake.

15 We've been thinking further about that option, and one thing we  
16 would like to explore is the extent to which we think that option, as  
17 modelled, may still overstate the journey time that would be achieved  
18 in practice. So, to be really clear there, we think that the actual  
19 journey time achieved may be shorter than the one that we have  
20 modelled.

21 We think that implies that there is a risk that the modelled  
22 results may understate abstraction. So actual abstraction may be  
23 higher than that that is modelled in option 15.

24 We also think that there is a risk that in that circumstance,  
25 because that faster service is more attractive, that may lead to further  
26 crowding effects and/or that that would give FirstGroup a strong  
27 commercial incentive to adjust fares, i.e. to increase fares in response  
28 to that better offer that is delivered to the market.

29 So that's the context. I think just before I turn it over to First, I  
30 think two particular questions come out of that thought process. I think  
31 the first is whether FirstGroup in particular have got any comments on  
32 whether you think option 15 is a reasonable reflection of the journey  
33 times that would be achieved in practice.

34 And the second question is, have you got comments on those  
35 effects: so the likely impacts in terms of abstraction, crowding and  
36 fares?

37 FIRSTGROUP:

38 I'll make a couple of comments and then my colleague will probably  
39 make a more detailed comment. Just to answer your question in  
40 terms of, first of all, whether option 15 is something that should be  
41 tested, i.e. with no overtake manoeuvre - yes.

42 I think as we've said before - without wishing to go over ground  
43 before - when we submitted the timetable, that was done to  
44 demonstrate that our proposal could be pathed on the railway. When  
45 the timetable process then happens and once a train is on the graph  
46 and it has a path, as the timetable is developed that path often  
47 improves and it may not require overtaking in future. So we  
understand why that's being tested and that's okay.

1 In terms of your points about crowding and whether that as a  
2 result of a slightly better journey time we would change our position in  
3 terms of commercial offer, then I think dealing with the second one  
4 first, that's not what's going to happen.

5 We've been very clear about the type of business that we are  
6 proposing. It is new. It is innovative. It's not done currently. We've  
7 made commitments in our application and discussions that we've  
8 shared with the ORR about the fares that we are proposing to offer.  
9 Those have been made and we are going to stick by those. That's the  
10 purpose of our business model, it is to offer a low fare.

11 Our service models have been primarily based on reservations.  
12 Using the systems that we've got, people will be able to reserve up to  
13 a few minutes before departure, so if they want to travel on the train  
14 and then they will be able to book minutes before departure and pay  
15 the fare that we are proposing.

16 And I think just before I hand it over to my colleague, I would  
17 just like to say if you think that as a result of our proposal that will lead  
18 to crowding, then we're obviously very pleased by the fact that you  
19 think our service is going to be very popular and our business case  
20 clearly works very well. So as a result of that we're quite happy.

21  
22 **FIRSTGROUP:** I don't think I've got much more to add other than to say that we've  
23 also tested the same scenario as CH2M Hill, and we've come up with  
24 a similar result in terms of the relativity between those two options.  
25 We think it represents a sensible sensitivity test for this issue.

26  
27 **ORR:** Okay, that's very helpful. I guess the particular thing I'd just like to  
28 come back on is that I understand your point that that's the business  
29 model you're launching today, or proposing to launch today, but if we  
30 are in a world where you achieve faster journey times won't your  
31 commercial imperative be to change that business model? I guess  
32 that's the nub of the issue.

33  
34 **FIRSTGROUP:** I don't see why. That's the bit I'm struggling with. I understand that  
35 today on the railways, if you had two services, generally how it works, I  
36 could understand why you might say 'Well, if the train's going faster  
37 and faster and they've become the fastest train and they're going to be  
38 the most popular train', but I don't think either that you're proposing  
39 that they are the fastest train. Actually what they would have is a  
40 similar journey time to Virgin's service.

41 So I think that's all you're suggesting is that Virgin would still  
42 have services that they're proposing to be trains to Edinburgh. We  
43 would be running five trains in one direction and five in another. So  
44 we're not running every hour.

45 We know what we're offering in terms of the available seating  
46 capacity, and we are marketing and we are proposing the service, and  
47 we've made those commitments in writing and in part of our proposal

1 that we've submitted to you. We've made those commitments about  
2 the fare that we will charge.

3  
4 **FIRSTGROUP:** I think the other thing to add as well is that the objective is to compete  
5 with the low fare airlines and coach operators as well, so in terms of  
6 the commercial pressure, if prices were to rise then you lose that  
7 competitive position with those other operators, and therefore we're  
8 more likely to stick to the business model we set out.

9  
10 **FIRSTGROUP:** And that's the last point - really it is not a model based on journey time.  
11 We haven't submitted this based on journey time. We haven't asked  
12 for journey time protection or anything like that. We are proposing to  
13 operate this service to compete with other modes of transport: air and  
14 coach. That's where we would generate our business from.

15  
16 **THE CHAIR:** Any other points before we move on?

17  
18 **ALLIANCE:** I fully agree with the points that Chris was making earlier. I think I  
19 don't really understand how First will manage demand. I think the only  
20 way that they could do it would be making the trains reservation only  
21 so you cannot board unless you have a reserved seat, otherwise the  
22 trains will be flooded. And the only way that that can be enforced in  
23 the railway that we have is by having a customer service assistant at  
24 every door checking everyone's reservation before they board the  
25 train. And that clearly has both cost implications and clearly time  
26 implications, because I can see some very long dwell times at  
27 Newcastle while that takes place in the southbound direction.

28 I'd be interested, in the context of that, to know what the actual  
29 capacity of these trains is, but I've also got a slightly more general  
30 point, which is about MOIRA. MOIRA, as I think we all recognise, is a  
31 very useful tool for understanding the generalised journey time  
32 implications of proposed services, but it is very sensitive to the precise  
33 ordering of trains on the graph. So if you have two trains to the same  
34 destination to pass one after the other nearly all the demand will be on  
35 the first train.

36 I mean, that's logical and what would have happened at the  
37 time that MOIRA was constructed, when BR was the monopoly  
38 provider of rail services. In the world that we now have, with open  
39 access, it's likely if you have two trains going to Edinburgh or Leeds or  
40 wherever, one open access, one franchised, departing a few minutes  
41 apart, some people will make a choice not on which goes first but on  
42 which has the costs and quality combination that they prefer.

43 So in reality, whether an Alliance service, for example, is just  
44 before a VTEC service, or a VTEC service is just before an Alliance  
45 service, won't make as much difference as MOIRA would suggest.  
46 And I think that's something to consider in looking at the MOIRA  
47 results for all these applications.

1  
2 THE CHAIR: Okay. Thank you.  
3  
4 ORR: We're going to pick up the capacity point next, but picking up the  
5 reservation point would be helpful.  
6  
7 FIRSTGROUP: Yes, I'm probably going to repeat myself, but it is the point again that  
8 the fares that we are proposing, if you want to purchase that fare you  
9 will get it with a seat, so it's reservation-based. Clearly if somebody  
10 has an inter-available fare and there is room for them to travel on the  
11 train then they can travel on the train, but they won't purchase that fare  
12 at the reduced rate.  
13 Our dedicated fare for our service is based on reservation, as  
14 we've identified in our business plan that we have submitted to the  
15 ORR.  
16  
17 THE CHAIR: Okay. Thank you.  
18  
19 VTEC: I'd like to largely agree with what Simon and Chris were saying. We  
20 have very severe concerns about the journey time. It's both the  
21 undertaking and the journey time that's been assumed. Compared  
22 with our journey time we reckon it's about 10 minutes slower than it  
23 needs to be. If you put those two together and model it just in MOIRA  
24 it more or less triples the abstraction you'd expect from the service,  
25 and that is a very significant change to the base service.  
26 We've actually got independent advice on what FirstGroup  
27 would be able to be likely to achieve in the event that both parties had  
28 rights in 2020 or whenever. We've got Tony Crabtree to produce a  
29 report, looking at the Network Rail decision criteria, and it's quite clear  
30 that if we both came in with equal rights we'd both get broadly equal  
31 journey times, so you could expect that in that circumstance there will  
32 be much more abstraction.  
33 When you put that abstraction together with the relatively short  
34 trains, and the fact they will be very attractive to interavailable tickets,  
35 their services will be massively oversubscribed. So a rational operator  
36 would do one of two things. They'd run longer trains and thereby  
37 increase the abstraction or they'd put the prices up.  
38 I imagine the easier option would be to put the prices up, and  
39 they've become more of a direct competitor to us than a coach and air  
40 competitor, as the original business plan said. And there'd be nothing  
41 to stop them doing that, and what rational operator wouldn't do that?  
42  
43 THE CHAIR: Okay. Thank you.  
44  
45 FIRSTGROUP: I just think I need to come back, because of a number of these points  
46 that are being made, and made directly about our proposition. I  
47 suppose what I come back to saying is that the commitments that

1 we've made are the commitments that we have made.

2 Clearly everybody thinks that our business is going to be a huge  
3 success, which is good news, and I'm looking forward to the decision  
4 that's coming. But having said that, and all joking aside, we're  
5 proposing to run five trains a day in each direction, not two trains an  
6 hour in each direction. Virgin will be operating two trains an hour from  
7 London to Edinburgh in each direction.

8 We're not running in the peaks. We're an off-peak service.  
9 We're targeting the air and coach market. Our business model works  
10 on the trains on which we are proposing, and I don't think I can say  
11 anything else because if I do I'll start repeating myself again.

12  
13 THE CHAIR: Okay. Thank you.

14  
15 ALLIANCE: I hear what Russell is saying about they've got a policy where it's  
16 going to be low fares. I think the concern from our side is it's really  
17 that enforcement, particularly on journey times, which drives revenue,  
18 but also about how the ORR would enforce low fares.

19 Because I don't think you could actually do that. We've raised  
20 this before but I think it needs to be said again, that you've got nothing  
21 really you could do. Russell says what he's going to do, but actually  
22 he could do anything that he wants in the long term.

23  
24 THE CHAIR: Thank you.

25  
26 DFT: So there's been some discussion that FirstGroup would be targeting  
27 the air market and the coach market, and not the train operator. I think  
28 that's ignoring the fact the air market is not a completely separate  
29 market. All of these applications, regardless of which is granted, will  
30 be seeking to compete with air travel on the London to Edinburgh flow  
31 - there's been significant changes in their market share over time as  
32 prices have changed and the service quality offered by the different  
33 operators have changed. So I don't think you can look at those as  
34 separate markets.

35 Specifically on the timetable point, I think it's critical that ORR  
36 undertakes its assessment on a realistic, central case scenario for the  
37 timetable, and from what we've heard the scenario in which the  
38 FirstGroup service is overtaken and is much slower is not a realistic  
39 central case. Thank you.

40  
41 THE CHAIR: Thank you. I'm going to move us on again. Have you got anything to  
42 say on that, Chris?

43  
44 ORR: I may have misheard. Just to clarify some things you said, Andy. So I  
45 think you said that you think that the journey times could be  
46 10 minutes faster than option 15 journey times?  
47

1 VTEC: Yes.  
2  
3 ORR: That's very helpful. There's some other points that relate to the  
4 FirstGroup application that, given that we've talked about this area, it  
5 would be useful to pick up.  
6 Largely these are the points that were raised in our January  
7 technical note relating to the proposed service; issues such as seating,  
8 the early morning service and coach competition. I was just going to  
9 again play back what we think currently about some of those issues.  
10 We've started to touch on this already, but there's the issue of  
11 the modelling by SDG of the higher density seating. We have had a  
12 conversation with FirstGroup about the seating configuration and the  
13 density of that seating, and our current view is that the proposition -  
14 comparing standard class with the standard class on the likely Virgin  
15 service - is for a comparable level of comfort.  
16 On the basis of that, we think on the point of whether there  
17 should be an adjustment relating to the quality of service, we think that  
18 the current treatment by CH2M is appropriate because we think that  
19 there is reasonable basis to believe that for standard class there will  
20 be a comparable service level.  
21 The second point is relating to the early morning departure.  
22 This is the issue around the extent to which it is realistic to expect  
23 significant numbers of passengers to be on the 5.30 departure from  
24 King's Cross, given the different surface access options available at  
25 that time of day.  
26 We have looked at this issue. The MOIRA modelling does  
27 model a lower number of passengers for that departure; that is one  
28 relevant point. The modelling results don't suggest that there are large  
29 numbers - or comparable numbers, I guess, if that's the phrase - on  
30 the 5.30 as there are on later services.  
31 But we do recognise the difficulties in terms of surface access.  
32 But I think in general terms we don't see that the modelled results  
33 need significant adjustment to reflect the difficulties in reaching King's  
34 Cross at that time of day. Noting that that service, when it first stops at  
35 Stevenage, is stopping at a more convenient time for access at those  
36 later stations.  
37 That's the second observation. The third one, related to coach  
38 competition, is the issue around whether the PDFH elasticities are  
39 reasonable or whether we need to make a further adjustment in  
40 respect of coach competition.  
41 Again, we think that those elasticities are drawn on evidence  
42 from the market that has coach competition in it, and we'd also note  
43 that we don't think that the orders of magnitude here are particularly  
44 significant in terms of the effects of coach competition in terms of the  
45 results. So on that basis again we don't think that there is a need to  
46 make a particular adjustment to the modelling results in respect of  
47 coach competition.



1  
2 FIRSTGROUP: I don't particularly have much to add to those. We've already put on  
3 record and had those discussions with you in meetings and submitted  
4 them, so you would expect me to say that we would expect there to be  
5 a benefit in terms of our competition with coach, and we believe that's  
6 there, so you might expect me to say that.  
7 And on your other points you might also expect me to say we're  
8 comfortable with your approach on the other two points.  
9  
10 THE CHAIR: Thank you.  
11  
12 SDG: I'd particularly like to go back on seating layouts. That's evidence  
13 we've provided. We haven't seen the detailed planned layout of the  
14 trains that FirstGroup are proposing, but we don't understand how  
15 they'd be able to fit the quantity of people they think on those trains  
16 without using more airline style seating and significantly less two plus  
17 two and table seating.  
18 Although there's limited evidence on passenger seating  
19 preference there was a study undertaken which found that passengers  
20 did prefer the option of a table and the ability to sit with a group, and  
21 we included these values in our appraisal.  
22 And we think this is quite a conservative estimate, the impact of  
23 going to that kind of seating structure, because the study was based  
24 on commuter routes. We think that people would have a stronger  
25 seating preference when they're using a long intercity service, perhaps  
26 with business colleagues or with their family.  
27  
28 THE CHAIR: Okay. Thank you. Russell, did you want to come back on that?  
29  
30 FIRSTGROUP: I haven't got a set of detailed plans to hand out so you can see the  
31 difference, but the trains are similar in that we're proposing to use the  
32 AT300, the Hitachi product, which effectively is the same trains for  
33 IEP. I'll give a little bit of detail; there will be slightly more airline  
34 seating, but not significantly. There will still be tables on the trains.  
35 The class 800 that exists and is currently under construction for the  
36 intercity express program for both Great Western and East Coast, their  
37 standard class coach is 26 metres long and has 88 seats, standard  
38 class seats.  
39 Now, if you did five times 88 you'd get to over 400, but clearly  
40 there are driving vehicles so some of the coaches will have that – but  
41 all of those coaches that have the 88 seats in them have tables. They  
42 have airline seating but they have tables as well.  
43 Our standard class coaches will have both tables and airline  
44 seating, and the pitch of the seats will be similar - the same as their  
45 current standard product.  
46 I could make another point that there are currently Mk III  
47 coaches in operation on the railway network today, on those routes,

1 that are 23 metres long, so they're shorter and they have 84 seats in  
2 them. So you could say the 88 seats in the 26 metre coach has better  
3 pitch than today. And our pitch, as I've just said, will be similar to  
4 those standard IEP layouts that are in the public domain, that have  
5 been seen.  
6

7 THE CHAIR: Okay. Thank you.  
8

9 ALLIANCE: Surprisingly I agree with Lucy on most of what she's said here this  
10 morning. A couple of things here, that the operator with 84 seats in  
11 the Mk III, is FirstGroup. Grand Central operates 64 seats in a similar  
12 vehicle. And part of our proposal to go to Edinburgh, of course,  
13 acknowledges the fact that most of the people flying early in the  
14 morning, whichever way, are business people, and therefore the  
15 importance of the seat space and some privacy will be the overriding  
16 factor for us.

17 And I think - I know you've got the information as well. You will  
18 see from our own fares structure that because of the number of  
19 services we offer and the availability throughout the day we're almost  
20 offering as many seats at a similar price to what FirstGroup are  
21 advertising, right across the day. And so I think that's quite an  
22 important point.

23 But for us, in a nine-car train, we're looking at around about 500  
24 seats. I still don't know how many seats we're talking about here in a  
25 FirstGroup train, but I do understand from Hitachi's plans initially that a  
26 normal VTEC train, which admittedly will have first class, is around  
27 about 330. So I'd still be quite interested to know the actual density of  
28 the seats.

29 And one other thing: I'm assuming from what's been said that  
30 there are no operator-specific walk-on fares for this service, but I'd just  
31 like to be sure that that's actually going to be the case. So if you  
32 haven't pre-booked it's interavailable or nothing?  
33

34 THE CHAIR: Okay. Thank you.  
35

36 ALLIANCE: Not on the issue of seats density, but on the other two points that Chris  
37 made. A 5.30 departure in the morning - clearly access costs will be  
38 high at that time of day, although granted the lack of congestion,  
39 access time may be low. But if you're paying £20 quite easily for a taxi  
40 fare to King's Cross that rather undermines the advantage of  
41 FirstGroup's low fare offer, even assuming that in reality it's  
42 deliverable. So that is a consideration.

43 The other point is on the coach market. I looked at how many  
44 coaches there are between Edinburgh and from Edinburgh and  
45 Newcastle to London, today, and there are five daytime services from  
46 Edinburgh and seven from Newcastle. So that's about 700 seats, and  
47 that's assuming 100 per cent load factor and it's assuming that

1 100 per cent of the journeys are end to end, neither of which are  
2 reasonable assumptions. So I do agree with you that the MOIRA  
3 elasticities do allow for coach competition.  
4

5 THE CHAIR: Okay. Thank you. I'll just bring in Andy and then I'll come back to you,  
6 Russell.  
7

8 VTEC: Andy Sparkes from VTEC. I just need to reinforce the 5.30 point. Our  
9 sister company runs a 5.30 from Euston to Glasgow. We've supplied  
10 the information in confidence to the ORR. But it has load factors that  
11 are an order of magnitude lower than FirstGroup are claiming, and we  
12 offer prices that are pretty similar to what they're proposing.

13 The point about that is not that the train is going to be empty,  
14 but the fact that if you're going to try and get 80 per cent overall the  
15 rest of the trains are going to be pretty close to 100, and you can't  
16 achieve that day in, day out, other than by significantly pricing up the  
17 busier days and thereby destroying the whole raison d'être of the  
18 service.  
19

20 THE CHAIR: Thank you. FirstGroup, did you want to come back in?  
21

22 FIRSTGROUP: Yes. So I'll deal with that 5.30 point. So yes, it is an early departure  
23 from King's Cross, but the key point of the service, which I think we've  
24 explained in our application and you just touched on a little bit, is that it  
25 will call at Stevenage, and the point at which it calls at Stevenage is  
26 still early in the morning, but it's around a similar departure time as the  
27 early morning flights from airports located near Stevenage, to  
28 Edinburgh, and that's the market that we are competing with. So that's  
29 actually the benefit of that service we run out of King's Cross, because  
30 that's where the train starts. So that would offer the opportunity for  
31 people to travel from King's Cross that early in the morning.

32 Both calling at King's Cross and Stevenage means that we will  
33 have an arrival time into Edinburgh before 10 o'clock, which is a good  
34 time to arrive for meetings. So we think it will be a popular service,  
35 and that's why we proposed it.

36 Just coming back on the seating point, while we haven't got full  
37 final design from Hitachi I imagine in the same way that Alliance  
38 haven't got the full final design for their rolling stock either, because  
39 our rolling stock investment is obviously dependent on decisions that  
40 are being made, but we have had discussions with Hitachi.

41 We have shared details. As Chris alluded to earlier we've  
42 shared commercially confidential details with the ORR as to what our  
43 seating layout will be. They will be five-car trains and they will have  
44 around 400 seats, but the exact number I can't tell you at the moment  
45 because we haven't got at the final design as yet.  
46

47 THE CHAIR: Thank you. Are there any other points that wanted to raise, before we

1 come to a break.  
2  
3 ALLIANCE: It was just a question I asked about an operator-specific walk-on fare.  
4 I just wanted to be clear that there no operator-specific walk-on fares.  
5  
6 THE CHAIR: Sorry, yes. That was a question to FirstGroup?  
7  
8 ALLIANCE: To FirstGroup, yes.  
9  
10 FIRSTGROUP: I think I've already reiterated our commitment around fares and the  
11 fact that we will - the majority of our passengers and our availability will  
12 be based on having reservations that are advance-purchase fares that  
13 you will be able to book up to the moments before the point of  
14 departure. Those are the fares that we will offer. So once the train is  
15 at capacity we're at capacity.  
16  
17 ALLIANCE: Sorry, that doesn't quite answer it, actually. It's a pretty simple  
18 question. On the day can I turn up and buy an operator-specific  
19 FirstGroup fare on that train - that's all I want to know - or can I only  
20 buy an interavailable fare? It's a simple question.  
21  
22 THE CHAIR: Do you want to answer that question?  
23  
24 FIRSTGROUP: Yes. Our current intention, I think as we put in our business plan which  
25 we've submitted, is that the operator fares will be the reservation fares.  
26  
27 ALLIANCE: No, not quite there yet but nearly, maybe. Can I buy an  
28 operator-specific walk-on fare for the train like I can for Grand Central,  
29 like I can for Hull Trains? Is there an operator-specific walk on fare  
30 without a reservation or do I have to buy an interavailable fare? It's a  
31 very simple question?  
32  
33 THE CHAIR: Do you want to say anything else, Russell?  
34  
35 FIRSTGROUP: I think I've been clear.  
36  
37 THE CHAIR: Right. Okay, I'm going to leave it at that point. Chris, do you have  
38 anything else?  
39  
40 ORR: So that concludes on Annex B. There's a long way to go on other  
41 things like fares next, but those are the issues that we thought would  
42 warrant discussion on Annex B.  
43  
44 THE CHAIR: So is there anything else on that area that we just covered?  
45  
46 FIRSTGROUP: Going back to the previous session, sorry. I just missed making this  
47 point before. If the request to you is effectively to take into account a

1 10-minute reduction in journey time based upon some material not  
2 seen, then we would wish to have the opportunity to comment on that,  
3 because it's not something that's come up in the work that's been  
4 done by CH2M and certainly not even flagged by SDG. So the  
5 request would be not to take that into account.  
6  
7 **ORR:** Just to be clear, are you asking about the extent to which we are  
8 thinking about what would happen with a faster journey time than  
9 option 15?  
10  
11 **FIRSTGROUP:** The request from Andy was, yes, to take into account a 10-minute  
12 reduction in journey time based upon some material apparently put  
13 together but not seen by anyone.  
14  
15 **THE CHAIR:** Just to be clear, are you referring to the specific piece of work that was  
16 made earlier by VTEC?  
17  
18 **FIRSTGROUP:** My understanding - it may be a misunderstanding - was that there was  
19 reference to some work done by Tony Crabtree, which was the basis  
20 of a 10-minute submission. But I may have misunderstood.  
21  
22 **THE CHAIR:** Let me just check. Is that material that is available to everybody?  
23  
24 **VTEC:** The report from Tony Crabtree we haven't shared with other people. I  
25 think we're prepared to do that. I'll confirm after the meeting, but we're  
26 prepared to do that.  
27  
28 **THE CHAIR:** That would address that. I wasn't aware whether everyone had seen it  
29 or not.  
30  
31 **VTEC:** And we haven't shared the 10-minute journey time reduction because  
32 we only did it yesterday, but we of course are prepared to do that once  
33 we've had a chance to refine it a bit more.  
34  
35 **THE CHAIR:** Right. That would address that point. That's very helpful.  
36  
37 **FIRSTGROUP:** Well, being able to come back on it would address the point.  
38  
39 **THE CHAIR:** Yes. I'm sure you will.  
40  
41 **FIRSTGROUP:** So can I just clarify? I think what Chris said in terms of option 15;  
42 option 15 was testing a journey time that was a similar journey time  
43 between the operators.  
44  
45 **ORR:** We've looked at that. Perhaps, Chris, you're the best qualified to  
46 answer.  
47

1 CH2M HILL: I think it's important for me to make the point that all of the options and  
2 base timetables have been discussed and agreed with ORR, and all of  
3 the options and base timetables have been shared twice with  
4 applicants: once in September and once in October. The option 15  
5 timetable is based on the journey times that we felt were reasonable  
6 based on the base timetable that had been predicated upon. Is it  
7 possible for trains with those characteristics to achieve faster journey  
8 times? Well, clearly, yes, it is.  
9

10 ORR: Just to say a bit more on that. So as Chris Judge just said it was  
11 based around the timetable in your application without the overtaking  
12 manoeuvre, so when we compared it to the VTEC timetable we did  
13 find that it was slower, accounting for differences in stopping patterns,  
14 by several minutes.  
15

16 FIRSTGROUP: I think that everything that Chris has said is fine, because that accords  
17 with the correspondence that you had with us when you suggested  
18 that you would do this additional sensitivity.  
19

20 THE CHAIR: Thank you.  
21

22 DFT: I mean, can I clarify then? It sounds like from this discussion that it's  
23 clear that - and sorry, I'm not a train planner, but I understand from  
24 those in the room that it's clear that the FirstGroup journey times would  
25 be faster and much closer to the VTEC journey times. So are the  
26 ORR saying that is the basis on which it will undertake its assessment  
27 of the FirstGroup application? Because at the moment there is just a  
28 sensitivity test which I think we're saying doesn't even reflect the  
29 journey time that you think is most likely.  
30

31 ORR: Okay. So I wouldn't characterise it as the way you've put it there, in  
32 that I think there is inevitably some uncertainty about the precise  
33 journey times that will be delivered in practice. I think what we're  
34 trying to understand is what are the impacts if the journey times differ  
35 from those that we've modelled? And we will have to take a view on  
36 whether those journey times have a significant impact on the modelling  
37 and the likely effects. We will have to take a view on what we think is  
38 most likely.  
39 So I wouldn't quite characterise it as that's our central or base  
40 scenario. I think we're just trying to understand the scenarios further.  
41 We need to take a view on what are the impacts and what we think are  
42 the likelihood of them. More complicated, I think, than what you set  
43 out.  
44

45 DFT: I mean, I guess from our point of view we think, again, it's critical that  
46 you take a decision on what's the most likely scenario. We accept  
47 there will always be uncertainty. But the central case that you should

1 present should be what's most likely. It's not sufficient from our point  
2 of view that you have a sensitivity test to show the most likely  
3 scenario. You should always have that as your base.  
4

5 THE CHAIR: I think on the basis of this discussion we will decide how best to  
6 present the information. I take that point, yes. But I go with the  
7 comments Chris has just made.  
8

9 ALLIANCE: It's just one point, John. If I recall correctly at the 12 June hearing, Tim  
10 O'Toole said that FirstGroup were expecting four-hour journey times  
11 for these services between London and Edinburgh. I just thought  
12 that's quite a useful point, because I imagine that drives towards what  
13 they think the business will be.  
14

15 FIRSTGROUP: I think we said that it was around four hours. I think that's what  
16 everybody has said. I appreciate the journey times you are proposing  
17 for your service are that much quicker because of the investment and  
18 the journey time and the speed of the trains which you want to  
19 achieve, but we said around four hours because that's the journey time  
20 that's there, that we understand from the timetables that you produced  
21 that is around the time - around four hours is the round number, which  
22 is what it is for VTEC's application is as well.  
23

24 THE CHAIR: Okay. Thank you. I'm going to take one final point from David, and  
25 then after the coffee break if there's any other point anyone wants to  
26 come back on we'll do that.  
27

28 VTEC: Just to conclude the point on the fares, I think it's clear that there is  
29 uncertainty as to what fare structure FirstGroup will offer, and  
30 particularly about the fare method as well, whether there will be  
31 operator-specific walk-on fares or not. I don't think we've established  
32 what FirstGroup's plans are.  
33 There is uncertainty. I think it's just important that ORR consider the  
34 possible options and take into account the uncertainty that clearly  
35 exists.  
36

37 THE CHAIR: Okay. Thank you. At that point we're going to take a break for 15  
38 minutes. So we'll come back in 15 minutes, and if there's any further  
39 issues that we didn't pick up already we'll just have a couple of  
40 minutes to do that. Thank you very much.  
41

42 **(The meeting adjourned at 11.33 a.m. until 11.49 a.m.)**  
43

44 THE CHAIR: We're just going to have two more minutes closing out the points from  
45 the discussion before the break before we move on to the fares  
46 overlay. I just wanted to clarify one point about further work that we're  
47 doing. Could I just hand over to Rob for one minute?

1  
2 ORR: Thanks John. Yes, I think we've touched on this but it was quite a  
3 confusing discussion.  
4  
5 THE CHAIR: Yes, I think it was.  
6  
7 ORR: We talked about option 15 as modelled by CH2M in relation to the  
8 FirstGroup application. It removes an overtaking manoeuvre that  
9 people have highlighted as unrealistic in various ways. We have  
10 ourselves noted that option 15 still leaves the FirstGroup journey times  
11 significantly slower than the equivalent VTEC services and we couldn't  
12 think of any good reason why that would be the outcome of the  
13 Network Rail process applying the decision criteria. So, on that basis  
14 we have already asked CH2M to model a further sensitivity, building  
15 on option 15, which speeds those trains up, to be the same as the  
16 equivalent VTEC services, taking account of calling patterns. So,  
17 that's a further sensitivity, we've already asked to be done  
18 independent of the work that Andy mentioned has been done for  
19 VTEC by Tony Crabtree, which I think we'd still like to see, and it  
20 sounds like it's going to be in the same vein. Our plan is to circulate  
21 details of the new sensitivity as soon as it's ready – which will be within  
22 a week or two, I'm sure.  
23  
24 THE CHAIR: Just to clarify, there are therefore two pieces of work that will be  
25 circulated round. Okay. Thank you. There were still some points left  
26 from the session. Russell?  
27  
28 FIRSTGROUP: I'd just like to clarify – just because David mentioned it at the end in  
29 terms of the walk-up fare – I realise that whilst I thought was being  
30 clear about what we're offering; it didn't come across as clear. So, just  
31 to say that, well, it's partly what Ian asked as well. So, Ian asked: 'Can  
32 I walk into the station and buy a fare?' As in a walk-up fare. Well, you  
33 can walk into the station and buy one of our fares on your phone, off  
34 your app, if there's a seat available, you can buy that fare, but you  
35 cannot go into the ticket office and buy a dedicated walk-up fare. It's  
36 the difference between "walking into" the station and a "walk up" fare –  
37 you can walk into the station if you're there at 5.20 a.m. in the morning  
38 and there's a seat available and you can buy a ticket, there will be a  
39 train you can get on. That is exactly our business, as we've just  
40 described it. We all think it's going to be very successful.  
41  
42 THE CHAIR: Thank you, Russell. If there are no other points on that area I'm going  
43 to hand back over to Chris. We're going to continue following through  
44 the structure that Chris set out at the start.  
45  
46 ORR: So we're now on Annex C, the overlay. The CH2M forecast fares  
47 competition to have quite a significant impact on more than one of the



1 applications that we're considering. And there have been a number of  
2 comments that have been made around the treatment of fares. We  
3 have spent a fair bit of time on this, and walked through some of the  
4 points, but in order to move the debate forward I'm going to ask Chris  
5 Judge to talk through the fares modelling in particular and the  
6 response to some of the points that have been made. Chris?  
7

8 CH2M HILL:

9 Yes, having reviewed the responses to our report, we thought it would  
10 be useful to clarify a couple of aspects of our modelling. Number one  
11 is how we have applied the passenger demand forecasting handbook  
12 to assess the impact of changes in fares. And number two is how we  
13 have modelled the response. We have used version 5.1 of the  
14 Passenger Demand Forecasting Handbook, 'PDFH' for short, which is  
15 the most recently available version. PDFH states that fares analysis  
16 should be conducted separately for individual market segments. We  
17 have followed this approach and the segmentation is shown in our  
18 report. The evidence used has derived the specific spread parameter  
19 contained within the logit function in Section B 11.4 of the PDFH,  
20 which is fairly old. We acknowledge this in our report but could find no  
21 good evidence to use an alternative figure.

22 PDFH states that the published conditional elasticities should  
23 be modified under certain circumstances. And there are three such  
24 circumstances that it lists. Number one is whether the change in fares  
25 exceeds 10%. For most segments in our model the change in fares is  
26 less than 10%. For a small number of segments, the change slightly  
27 exceeds 10% but based on the stated PDFH elasticity modifiers,  
28 adjusting these elasticities would have no meaningful change in  
29 revenue projections.

30 The second criteria where one might wish to modify elasticities  
31 is if fares differ from the national average. Based on the information  
32 we have access to, we could not find evidence to suggest that in the  
33 base case for any of our options, fares do differ or would differ from  
34 the national average. We have a problem here of a lack of data  
35 relating to the fares that would be offered in the future by the  
36 incumbent operator. We received a small number of sample fares  
37 from VTEC and statements around the dependency between  
38 managing loads and the availability of the most heavily discounted  
39 fares. We've asked VTEC to support that with more detailed future  
40 fares data and specifically from its recent bid model which we've  
41 thought would have been a good source of that data. And VTEC didn't  
42 respond to the request. So, it made us have to make more of a  
43 judgement in terms of incumbent fares than we ideally would have  
44 liked to but that's the situation.

45 The third statement in PDFH around modification of fares  
46 elasticities is if the GDP per capita, as a proxy for income, differs from  
47 the national average. We hadn't perceived significant differences to  
the national average for the flow served and viewed adjustment of the

1 elasticities with respect to the GDP as a second order consideration  
2 versus the more fundamental uncertainties which we have referenced  
3 in our report.

4 So, that is a brief summary of how we applied the passenger  
5 demand forecasting handbook to assess fares. I haven't mentioned  
6 yet the competitive response element. I think it would be needed to  
7 pick that up second.  
8

9 THE CHAIR: Shall we pause there for one minute before we move on to the  
10 competitive response point? Does anybody want to comment at this  
11 point? There'll be another chance later on, after the competitive  
12 response point.  
13

14 SDG: I would like to make a point about the general modelling of fares, I  
15 think, before the competitive response point, if that's ok?  
16

17 THE CHAIR: Okay.  
18

19 SDG: First of all, picking up on the elasticity modifier point you just made,  
20 Chris, about the average fare. Just reading the PDFH here I think you  
21 can read it either way, but, I think you could read it that actually it's the  
22 average fare level compared to where they were in 2007, rather than  
23 where the average fare level is now. So, it might be worth considering  
24 that. It's also a point we didn't consider in our analysis. So I can't  
25 actually push that too strongly but I think it's worth flagging that may  
26 still be valid –  
27

28 CH2M HILL: To clarify – we did consider that.  
29

30 SDG: Fine. Generally though I'd like to make a fundamental point about how  
31 CH2M modelled the impact of undercutting fares. And that's the way  
32 they've allocated it between operators. So, CH2M, as I understand  
33 their details in Appendix C, assumes that the demand growth that  
34 would occur, due to lower fares, from one operator will accrue to both  
35 operators in the market. To us, this just doesn't follow common sense.  
36 If a person is attracted to the railway because of lower fares, that are  
37 only valid on some services, then, surely, those people will be  
38 travelling on those lower fares – and only on the services on which  
39 those lower fares are valid. They won't be choosing to travel on the  
40 VTEC services, at fares that were already available in the base case.  
41 If they're coming in because of the lower fare, naturally they should be  
42 travelling on those lowers fares. And I think the fact that CH2M has  
43 not assumed this is a fundamental flaw in their approach. I understand  
44 that CH2M have put two points in in support of this – what we consider  
45 an erroneous assumption. They suggest that the example in the  
46 PDFH Section B 11.4 supports them. I've had a look at this example  
47 and actually it doesn't go on to allocate the demand growth from fare

1 reductions to the operator. So, we think this is a bit of a stretch to say  
2 it supports their assumption. CH2M also claimed that the fact that  
3 their assumption is the only one that returns no revenue change when  
4 the fare elasticity is minus one supports this position – for the  
5 economic theorists, CH2M have said in their report, if you have a fare  
6 elasticity of one for the whole market, then the change in demand for  
7 any fare change will be equally and oppositely met by the change in  
8 yield.

9 So, you'd have no change in total revenue. That's noted in  
10 CH2M's Appendix C as a footnote in support of their argument. And  
11 we think that shows a misunderstanding of the complexity of this  
12 market. There are actually a lot of sub-markets within each of the  
13 individual markets that they will have modelled. All have different price  
14 elasticities. By offering an undercutting fare product, you are trying to  
15 attract some of the people with a different price elasticity even within a  
16 market segment within that market and so you could – even with an  
17 overall average price elasticity of minus one – have an increase in  
18 revenue or a decrease in revenue, in fact, if you had too much leakage  
19 of people moving from the VTEC product to the cheaper product when  
20 the price before was the ideaFTPE.

21 I think most essentially it just fails the common sense test as I  
22 mentioned before. If people are travelling because of lower fares, we  
23 expect them to travel on the lower fares.

24 I think this then leads to CH2M making a further fundamental  
25 error because they're not accurately allocating demand to the operator  
26 offering the undercutting fare, they're underestimating the load factors  
27 FirstGroup would achieve. So, our own analysis has shown that if  
28 FirstGroup did offer a fare reduction of 40% or 50% under that of  
29 VTEC that they'd achieve load factors in excess of 140%. Now, these  
30 kind of load factors are just not believable and we've already talked  
31 about how these are higher density trains. Whether or not you could  
32 actually fit 140% of people with seating capacity on the trains  
33 physically is quite questionable. Moving on to the willingness of  
34 people to stand between London and Edinburgh – that is not likely on  
35 a long term basis. It might be on the Friday before the Edinburgh  
36 fringe or something but they're not going to do it on a wet Tuesday in  
37 January.

38 And that takes me to the other point. And I think this one was  
39 made earlier – that there are natural variations in demand. So, if  
40 you're going to get an 140% average overall load factor, that must  
41 mean some trains are full to the gunnels literally – people sitting three  
42 a deck, on each other's laps because you'll have naturally some trains  
43 that are at most 100% or even below, as we've had some discussion  
44 about before. And, as a commercial organisation, I think Chris made  
45 this point earlier, as a commercial organisation, if FirstGroup are facing  
46 those kind of load factors and that kind of demand, they'll naturally  
47 increase their prices, and increase their revenue, rather than just send

1 people away.  
2 So, overall we think that they would end up with a much  
3 reduced fare discount than they have proposed and by the fact that  
4 CH2M are incorrectly allocating the demand from fares growth they  
5 are not coming to the same conclusion as we are.  
6

7 THE CHAIR: Ok, thank you. I'm going to ask Chris to come back on those points,  
8 and in particular the allocation points.  
9

10 CH2M HILL: I can only answer the question in terms of the facts of what approach  
11 we have used. And the approach we have used is exactly as is stated  
12 in the Passenger Demand Forecasting Handbook and ORR can read  
13 it.  
14

15 THE CHAIR: Okay. Well, let me bring a few people in. Do you want to go in to this?  
16

17 ORR: I think it's a challenge on the CH2M methodology so it probably would  
18 be useful if Systra comments.  
19

20 SYSTRA: We looked at this point very carefully and we looked at PDFH, and in  
21 fact I was the editor of this part of PDFH anyway. It is clear, it says,  
22 that the estimate there is a market share. It is clearly calibrated for the  
23 market shares. It's the standard approach to use from the logit choice  
24 model, which is of market shares and therefore it does apply to the  
25 market shares. And you have to be careful that the parameter in it is  
26 appropriate and it doesn't have obscure effects, silly effects, which  
27 generate extra demand for say the incumbent operator. And that we  
28 checked through as well as the checks we did during the audit. We  
29 are confident this is the appropriate way of modelling on correct  
30 economic grounds and it's the appropriate way as specified in PDFH.  
31

32 SDG: So, you're suggesting that – say there were two operators operating  
33 right now – one reduces their fare – that will lead to increased demand  
34 for the other operator?  
35

36 SYSTRA: No, it doesn't reduce the fare – it increases the overall demand – and  
37 the percentage of demand given to each operator is according to the  
38 formula in 11.4.  
39

40 SDG: So, some of it would be allocated to VTEC, in that case, then?  
41

42 SYSTRA: Implicitly, it's the wrong way of thinking of it. There's an increased  
43 benefit to the whole market –  
44

45 SDG: – because of the lower fares that are only valid on one of the –  
46

47 SYSTRA: – it's standard modelling.

1  
2 THE CHAIR: Okay, let me – if we pause on that one now. I just want to bring some  
3 other people in.  
4  
5 ALLIANCE: Well, perhaps some surprise that I wholly agree with DfT and Lucy  
6 Kavanagh on this point. I guess not on everything else but on this  
7 point – it seems to me that implicitly, even though this isn't – perhaps  
8 John will argue not quite the way that it operates – this is a two stage  
9 process. The first stage is that the market gets reallocated between  
10 the operators so the lower fare operator gets a higher share of the  
11 market than they would have done just on the output from MOIRA and  
12 the second stage is that the market is grown and it seems not only that  
13 it doesn't follow a rationality test to give some of that growth to the  
14 operator with the higher fare, but also you can quite easily – I've  
15 played around a little in spreadsheets to do this – demonstrate that  
16 what happens if you apply it to the – if you give the full growth, say  
17 20% reduction, the full 20% reduction – to the lower fare operator, you  
18 do end up with elasticity of minus one with no change in the overall  
19 size of the market. I'm happy to share that little spreadsheet with ORR  
20 and indeed everybody else after this session.  
21  
22 THE CHAIR: Okay. Thank you.  
23  
24 CH2M HILL: May I respond?  
25  
26 THE CHAIR: Yes.  
27  
28 CH2M HILL: We can intellectualise all we like about what the PDFH does or doesn't  
29 mean. The fact is that it is written in black and white on how to  
30 apply this particular methodology and we have to follow this in black  
31 and white. We could talk about examples where on average  
32 somebody between 12 weeks out and the day of departure would pay  
33 slightly less when the average fare's reduced using any particular  
34 media like the Trainline, but I would contend that it's a complete waste  
35 of time because we have used the PDFH to the letter and I just think if  
36 we could reflect on our previous testimony in June where several  
37 members of this panel in the round, have advocated that the PDFH is  
38 the industry best practice and something that we should not depart  
39 from. So, it just seems highly inconsistent to me that we are now  
40 saying that this is flawed and we shouldn't be using it. We've used it  
41 exactly to the letter.  
42  
43 THE CHAIR: Okay. A few more points.  
44  
45 ORR: Yes. So, as Chris just alluded to, this is an issue that's been in  
46 discussion a long time. It's something we picked up before the hearing  
47 and talked to CH2M about. And a lot of people around the room

1 who've got a lot of experience in fares modelling know it's very difficult  
2 and there are often rather strange things happening, so we've talked  
3 about it. We have had plenty of time to think about whether it's the  
4 right approach and we've talked it through with CH2M and of course  
5 we've talked it through with the auditors, as well, and for the reasons  
6 that Chris and John have said, we've decided it's the best approach.  
7

8 SYSTRA: Can I just add - of course, this formula, in PDFH, was specifically  
9 developed in the context I think of open access operations by MVA on  
10 behalf of ORR in 2009?

11  
12 SDG: At much lower levels of fare discount than are being discussed here.

13  
14 SYSTRA: Yes. At relatively low levels of fare discount – I should have said that.

15  
16 THE CHAIR: Thank you. Let me just bring Bobby in.

17  
18 VTEC: Just – we will have further points to make on this – but just coming  
19 back on some of the points that have already been made. First of all,  
20 we would contest some of the statements that CH2M have made  
21 about whether or not it would be appropriate, given the criteria CH2M  
22 have mentioned, whether or not it would be appropriate to apply  
23 elasticity modifiers in these circumstances. I don't have any evidence  
24 to hand but we can provide further evidence.

25 And the second point is that for the PDFH Chapter B, 11.4  
26 methodology we have been discussing, my understanding is that the  
27 calibration of the spread parameter and it is specifically mentioned in  
28 that section – it applies to the walk-up fare differential. Therefore, it is  
29 not the spread parameter and the situation, it is not necessarily  
30 appropriate, and it casts uncertainty over the methodology, the fact  
31 that it is being applied now, in a sense where a lot of the fares being  
32 offered are advance purchase fares.

33  
34 THE CHAIR: Ok, thank you. It's quite clear, there are quite a few differences of  
35 view here so can I just ask people: have you got any further additional  
36 points that haven't already been raised rather than simply repeating  
37 points?  
38

39 ALLIANCE: Mine's quite a simple one, John, I think. I'm not a great lover of  
40 models, as Simon will probably tell you, because if modelling always  
41 gave you the answer, we wouldn't be sat here today because it would  
42 be very easy for you to run. But I think Chris said this, the PDFH, as  
43 well, is based on industry best practice, and I believe Simon when he  
44 tells me and John that that's probably the case. But we've heard today  
45 this is not industry practice. This is a completely new type of structure.  
46 The only time I can ever remember the railway having fully reservable  
47 trains is holiday trains in the southwest, when I used to work in the

1 southwest, but based upon quite expensive fares, at the time. Now,  
2 this is completely different. I cannot get on this train unless I've pre-  
3 booked it on the telephone, as I've been told – unless I've pre-booked  
4 it on the phone, I can't get on the train. Now, you show me anywhere  
5 in PDFH based on BR and anything that's happened since  
6 privatisation where what we're talking about now has actually  
7 happened before. And that's why I think I have to agree with what  
8 Lucy and Simon have said: this is just counter-intuitive. It just doesn't  
9 make sense. If I have to ring up to get a ticket for £25, but can't get  
10 that ticket for £25, and have to pay £150 to travel with someone else,  
11 then, how does that £25 become split up – it just doesn't work. And if I  
12 have to pay £125, I'm not going to go, because I will have had to have  
13 booked it beforehand.

14 The other thing is – and I think this is a passenger point of view  
15 – I turn up at the last minute with an inter-available fare and every seat  
16 is sold on the 5.30 a.m. train in the morning, how do I get decent value  
17 for money on the basis that I've got to stand up? And I thought the  
18 whole idea of inter-availability – and one of things you dealt with some  
19 years ago with Platinum Trains – because they sponsored something  
20 very similar – is that you actually exclude a piece of the market, so it is  
21 quite important.

22  
23 THE CHAIR: Ok, thank you.

24  
25 VTEC: I'm going to find myself agreeing with Ian. I think Chris Judge himself,  
26 or CH2M themselves say in the report that this is a highly complex  
27 area to model – 'stretching the frontiers of current forecasting  
28 research' – and I think it's been stretched to breaking point here. You  
29 can't safely make a decision relying on PDFH applied perfectly  
30 (whether or not we can agree that it has been applied perfectly). But  
31 even if it has, if it's produced some implausible results and we  
32 shouldn't be looking at them. We'll come back to this later but some of  
33 the results are way outside current industry experience.

34  
35 THE CHAIR: Ok, on that, I think all those points have been quite clearly made so I  
36 think on that basis we should move on. Simon?

37  
38 ALLIANCE: I think we've discussed this question of whether all the growth from  
39 lower fares should be applied to the operator who has the lower fares  
40 and I think there is clearly different points of view on that point, but I  
41 think we ought, more broadly, to recognise that the ORR has little  
42 ability to influence the level of fares that are actually charged, given  
43 that fares modelling is inevitably an area of risk in the overall  
44 assessment process. There are weaknesses apart from the point  
45 we've been discussing with the modelling framework that is available  
46 but given the limited role that the ORR has, I don't think that those  
47 weaknesses are fatal. So, I don't think we need to spend a lot of time

1 arguing about things like elasticity modifiers – although, it’s an  
2 interesting technical discussion. What I do think are the two issues  
3 that are of – well, I think there are three issues – a) it’s an area of risk  
4 generally in your decision-making; secondly) who gets the benefit from  
5 one operator charging lower fares, which we’ve discussed; and the  
6 third, which we’re just going to go on to, is competitive response.  
7

8 THE CHAIR: Ok, thank you. One final point on this. Simon?

9  
10 DFT: I think, regardless of the PDFH issues, you need to step back and  
11 think about this in terms of common sense. So, we’ve heard earlier  
12 that the FirstGroup service is likely to have about the same journey  
13 times as the VTEC service. FirstGroup say that they will have the  
14 same types of trains with about the same seating configuration. So,  
15 we can take them on their word on that. Load factors, once we get  
16 into the 2020s, are expected to be very high on the East Coast, in any  
17 scenario, and so the trains are likely to be very busy. So, if there’s a  
18 lot of demand, you’ve got about the same journey times and about the  
19 same trains, why wouldn’t you charge pretty much the same fares?  
20 It’s just common sense. That would be their commercial incentive. If  
21 they did charge much lower fares, their trains would obviously be very  
22 busy, but why would they?  
23

24 THE CHAIR: Ok. I think we have registered there, there’s a set of technical issues  
25 and a set of what I think various people have called common sense  
26 issues. So, I think we’ve all noted that. Can I move this on to the  
27 competitive response point now? And then we’ll wrap up anything else  
28 at the end.  
29

30 CH2M HILL: And there’s a link between what we have just been discussing and the  
31 competitive response point.  
32

33 THE CHAIR: Yes, indeed.  
34

35 CH2M HILL: I’d just like you to flag that our report acknowledges clearly the key  
36 uncertainties in our work. And our view on those uncertainties is  
37 driven by a number of things, including our knowledge of PDFH, our  
38 knowledge of current yield management practices, discussions with  
39 the independent auditor, discussions with stakeholders and also  
40 stakeholders’ responses to our October 2015 methodology report.  
41 And we have been clear to state that the key uncertainties are: not  
42 having access to VTEC’s fares strategy for the future, the age of the  
43 evidence used to derive the PDFH spread parameter, and the absence  
44 of advice in PDFH on how to derive a competitive fares response.  
45 We’re clear on that.

46 In terms of the competitive response itself, common sense  
47 economic theory and evidence from a great many industries would



1 suggest that when one organisation is faced by a new entrant which  
2 reduces the price, the other organisation would seek to compete on  
3 price. Nevertheless, PDFH does not offer us explicit advice on how to  
4 develop a competitive response scenario and we have therefore  
5 developed our own scenarios. The report is clear that these scenarios  
6 do not come from PDFH. We have assumed that VTEC would seek to  
7 offer the empty seats on the services that operate immediately before  
8 and after a new entrant's services for the same price as the new  
9 entrant. We recognise that this is an assumption so we conduct a  
10 sensitivity test where the discount offered is halved. And in our model,  
11 that's the equivalent of offering the full discount on half the number of  
12 empty seats. That's what we've done.

13  
14 THE CHAIR: Okay.

15  
16 ORR: In terms of one of the issues, I think Chris set out clearly there that  
17 what general evidence tells us about what happens when there is  
18 competition on the route, where there was less competition before.  
19 So, to try and turn this to some specific issues, we are more interested  
20 in the debate around the magnitude of competitive response rather  
21 than whether we think there is one or not. Against that background –  
22 the magnitude of competitive response – I think that some of the  
23 arguments VTEC have put forward on competitive response point  
24 towards the role of airline competition. I think it's useful to be clear on  
25 that – is it correct to understand your position is that the strength of  
26 that competition with airlines is such that, before any entry, the VTEC /  
27 airline competition is sufficiently strong that the addition of additional  
28 rail services and the addition of more rivalry, won't make a difference  
29 to your price – or a significant difference to your price? And is that  
30 airline competition sufficiently strong to mean that the additional  
31 capacity and the additional rivalry on rail will not cause a significant  
32 competitive response?

33  
34 VTEC: Yes, I think that's absolutely right at Edinburgh, between Edinburgh  
35 and London certainly. We are already competing with Ryan Air at  
36 £9.99. First Group at £25 is not going to make a lot of difference in  
37 that, in our pricing. And anyway, as we've just heard, the train's going  
38 to be stuffed to the gunwales. We might as well just accept that we're  
39 going to lose people and carry on as before because the main  
40 competition is Ryanair.

41 I think the other point to make about this is the Leigh Fisher  
42 report is very valuable evidence in this area. That has found no  
43 evidence, historically, of competitive response. Now, you might say  
44 that there must be some there and, yes. Maybe, maybe not. But the  
45 point is that if there was any there, it wasn't big enough for it to be able  
46 to appear out of the statistical noise. So, it must have been relatively  
47 modest.

1 And most important of all, what they found is that even with  
2 whatever competitive response that has been there historically, the  
3 NPA ratio was still around the 0.3 threshold. Not these incredible  
4 numbers of 0.81 or 1.5 that are coming out of the CH2M analysis. So,  
5 whatever competitive response is there, is not making a significant  
6 difference to the NPA ratio.  
7

8 ORR: So, let's take those in turn. I think your comments on airlines are quite  
9 clear. Am I right then – you're saying that the entry by alternative  
10 services, those additional six services, every passenger that you lose,  
11 you will attract from the airline market without having to lower your  
12 fares?  
13

14 VTEC: No, no. We would have a net loss of passengers but –  
15

16 ORR: Net loss of passengers – I'm trying to understand. If your position is  
17 you're competing ferociously with the airline market –  
18

19 VTEC: Yes.  
20

21 ORR: That also implies that a small change in your fares will attract  
22 passengers back from the airline market?  
23

24 VTEC: Yes.  
25

26 CH2M HILL: I had understood that the number of heavily discounted tickets that you  
27 currently offer on Anglo-Scottish services is constrained by  
28 overcrowding. So then I don't understand how you can further  
29 compete with the airline market by lowering fares.  
30

31 VTEC: What we do today, we monitor airline fares and that all goes into our  
32 revenue management software and we monitor that on a daily basis.  
33 So, we have fares at these levels that we're talking about today and in  
34 a lot of these cases they're not all sold. There are times of the day  
35 where we do have busy trains but that isn't reflected in higher fares but  
36 across the piece, there are fares today at these levels and they're not  
37 sold. So, to say that putting these fares in will attract more from the  
38 airlines is just – doesn't feel right to us.  
39

40 ORR: So, if I'm understanding you correctly, you're saying that the entry by a  
41 competitor will mean that you have fewer passengers travelling?  
42

43 VTEC: That's right.  
44

45 VTEC: Yes.  
46

47 ORR: Why wouldn't you then change your fare strategy and compete to

1 attract those back? Or a proportion of them back? So, you're facing  
2 lower demand for your service – is your position that you'd maintain  
3 your fares and wouldn't respond to that entry?  
4

5 VTEC: Well, I think you've got to take into account the fact that we're  
6 providing a set number of services a day within the market you've got  
7 a load of air services every day – there's 48 air services. This was  
8 back in, at the end of 2014 – there were 48 air services per day  
9 between Edinburgh and London. You've got to ask yourselves, is five  
10 additional rail services going to make such a difference in the  
11 competitive market that either ourselves or indeed one of those airlines  
12 will change their pricing. You've got to take a view on that. In my  
13 mind, five additional services out of a total of 75, 80 services a day,  
14 that's not going to be significant. So, what I'm saying is: we will  
15 continue to face significant competition from the air services on that  
16 route – and they are essentially the price leaders in this market. And  
17 that is the case in the base case as well as the cases that you're  
18 testing.  
19

20 ORR: So, I guess what I'm trying to understand and trying to make sure is  
21 that we are being consistent in how we are understanding the nature  
22 of the competitive constraints in this market. So, what I'm hearing you  
23 say is you're competing actively with the airline market.  
24

25 VTEC: Correct.  
26

27 ORR: So, if that is the case, that means that as you change your prices  
28 passengers will switch.  
29

30 VTEC: Yes.  
31

32 ORR: So, we then combine that thought with your own view you think you  
33 will be competing for passengers with any new service.  
34

35 VTEC: Yes.  
36

37 ORR: So, passengers would switch from your service to an alternative  
38 service?  
39

40 VTEC: Yes.  
41

42 ORR: Surely you would then adjust your fare strategy in response to that  
43 change and compete passengers back from both the new rail service  
44 and from the airline market?  
45

46 VTEC: But it would be very marginal because the price setters in this market  
47 are the airlines and the competition that we would see in the market

1 from First Group would not significantly change the competitive tension  
2 that we already face and face in the base case with the airlines. So,  
3 the airlines do act as a constraint already. That was found by the CMA  
4 back in February last year. So, they do already provide significant  
5 competitive tension and they – because of the level of services that  
6 they provide, they lead on pricing on the route.  
7

8 **ORR:** Okay.  
9

10 **VTEC:** I think the issue is not: Can we win back passengers? The issue is:  
11 does it change the revenue maximising fare for VTEC? And I think  
12 that answer would be: Not a lot. Because airlines are the price setters.  
13

14 **THE CHAIR:** I just want to see if anyone else wants to come in?  
15

16 **ALLIANCE:** The impact may be marginal with, competing with the FirstGroup  
17 application, five relatively small trains a day. With the Alliance  
18 application, which is a much larger number of much larger trains, then  
19 one would expect the competitive response would be a much more  
20 significant impact on the market. One would expect there to be a  
21 much greater affect. And while I'd agree with the points that Chris  
22 Hemsley's been making, that makes it rather strange that the one  
23 application where competitive response has not been modelled is in  
24 relation to the Alliance Edinburgh application, where what we have  
25 consistently said is that we believe that because the service is faster  
26 and very high quality it should be capable of attracting a fare premium.  
27 But we haven't assumed that in our revenue forecasting and indeed  
28 CH2M Hill haven't assumed it in their revenue forecasting. And the  
29 reason that we say that is because we believe in the real world there  
30 would be a competitive response from VTEC and therefore the net  
31 result will be that our fares will end up on average at around the  
32 current VTEC level. And their fares will end up significantly lower.  
33 And we do think that it's a weakness in the work that's been done to  
34 date that that hasn't been taken into account.  
35

36 **THE CHAIR:** Ok, thank you.  
37

38 **FIRSTGROUP:** I was just going to make a point on the competitive response in  
39 general and a point, because Andy Sparkes referred to the Leigh  
40 Fisher Report – I think it's just important that we are very clear about  
41 what the Leigh Fisher Report found – so, on page 18, it says: 'This  
42 finding does not represent conclusive evidence there has not been a  
43 competitive response, merely that we have not identified conclusive  
44 evidence of one'. And the report, the primary objective of the report,  
45 wasn't actually to evaluate historical yield and fares data, it wasn't to  
46 determine whether there had been a competitive response. And that's  
47 clear in the report. So, the report didn't say: There isn't a competitive

1 response and there hasn't been one.

2  
3 THE CHAIR: Can we give Chris Judge a chance to come back?

4  
5 CH2M HILL: It was just a point of principle on the fares response on fares that  
6 we've modelled for Alliance and Edinburgh service. If the proposition  
7 is not to compete on fares, as we understood it, with the incumbent,  
8 then it's not a thing we can model in terms of trying to assess what the  
9 incumbent competitive response on fares would be, by definition,  
10 there's no fares competition. If you're asking me to reflect on the  
11 advice the report gives to ORR, I think it would be reasonable for  
12 ORR, given the level of abstraction in this case, to reflect on what the  
13 impact might be on the income of the incumbent operator and how the  
14 service might develop on that basis.

15  
16 THE CHAIR: I would like to bring a few more people in. Lucy?

17  
18 SDG: Yes. I think we would agree with VTEC that there wasn't any evidence  
19 found in the Leigh Fisher Report of competitive response and also that  
20 they're constrained by the airline market. But even if there was some  
21 competitive response, as Andy Sparkes said, because the Leigh  
22 Fisher Report found that there was not conclusive evidence, it implies  
23 that if there is some competitive response in the market, it's relatively  
24 small. We think that CH2M are probably overestimating the impact of  
25 competitive response in terms of price reduction because of the  
26 formula they've used to determine what the fare reduction might be on  
27 VTEC. So, CH2M seem to have made up a formula for this purpose.  
28 There's not an industry standard approach. They've invented  
29 something. It's not very well documented what they've invented.  
30 We've tried to puzzle through their Appendix C to work out what  
31 they've tried to do. Having puzzled through it and tried to work out  
32 what they might be trying to do, we think they've made two errors in  
33 this formula. One of which is the weighting. We've said that in our  
34 letter. But the other one is that they seem to consider total empty  
35 seats on the VTEC service. I think that's what Chris said a bit earlier,  
36 whereas, surely, you should only consider the additional empty seats  
37 that are additionally empty because the service has competition?  
38 Because surely if in the base case it was in VTEC's commercial  
39 interest to fill the empty seats on their service, they would be doing so,  
40 and pricing accordingly. You should only be considering the extra  
41 empty seats that are available because of the additional competition.  
42 Now, we've taken a simple example, as we haven't got the exact  
43 numbers that CH2M have used. Correcting these two errors, and the  
44 most significant one is to consider all empty seats, would actually take  
45 the assumed VTEC fare reduction from 8.6% to 2.5%. So, it's a  
46 significant difference to the fare reduction that would be assumed for  
47 VTEC and that's even if you accept that the formula that CH2M have

1 created for this purpose is the correct one which, we haven't actually  
2 seen any evidence behind that; any evidence that would be the fare  
3 that would be undertaken. So, I think that's a key point. Even if there  
4 is a competitive response we think the scale of it is being inaccurately  
5 estimated. And I think Chris alluded that they've already done a  
6 sensitivity of halving that. We have a concern – we've heard a lot of  
7 sensitivities of things where the modelling probably isn't quite right.  
8 We're reminded that actually the central case is a combination of these  
9 sensitivities. And if you test each of them as an incremental  
10 sensitivity, you're not really reflecting where you actually should be in  
11 totality. So I think that would be my point on that.

12  
13 THE CHAIR: Okay. Thank you. Did you want to come back Chris?

14  
15 CH2M HILL: We do, yes, please John. Given that the accusation is that there are  
16 errors manifest in the report, I feel I probably should. And just as a  
17 general point, the whole report has been verified by an independent  
18 auditor. That applies to everything we've done. The report is clear  
19 that PDFH did not offer advice on how to develop a competitive  
20 response scenario. It is clear that they are our assumptions, based on  
21 our own understanding of yield management practice and what would  
22 be likely to happen or could be likely to happen in the advent of the  
23 competition as it's described in our report. We have reviewed  
24 stakeholders' responses on the issue and whilst we do not necessarily  
25 agree with the approach that's suggested, or the algebra that  
26 underpins that approach, we have conducted some preliminary  
27 investigations into the magnitude of the response using the suggested  
28 approach, and the revenue impacts, to us, appear to be within the  
29 range of the scenarios that we have presented in our report.

30  
31 SDG: We wouldn't even accept that the formula's appropriate in the first  
32 place.

33  
34 CH2M HILL: So, your suggested approach I think is that the competitive response is  
35 based on the total number of additional seats. So, we have also  
36 checked using that approach. That's what I've just described.

37  
38 SDG: We were saying that what your formula seemed to be doing, there was  
39 a fundamental error. I don't think we were saying that was the  
40 appropriate approach for estimating the fare reduction for VTEC. So, I  
41 just wanted to make that clear.

42  
43 THE CHAIR: Can I just ask on that point; did you want to come in at all John?

44  
45 SYSTRA: Nothing much more to add to what Chris Judge has said. Yes, we  
46 looked at this element of it. We recognise the extent of competitive  
47 response is a judgment call to some extent. It was a reasonable

1 model but you can take alternative views which is why we're  
2 comfortable – it's important to do sensitivity tests and, yes, the ORR  
3 will need to take this decision on which is the central case to have it, in  
4 terms which it recommends to its Board.  
5  
6 THE CHAIR: Ok, thank you. John?  
7  
8 FIRSTGROUP: Yes, just a quick one really. So, the Leigh Fisher work was  
9 inconclusive around whether there was a competitive response or not.  
10 There is another study that's listed in Leigh Fisher's work that looks  
11 much more specifically at on-rail competition from 2009,  
12 commissioned by ORR. And that study looks at the relationship  
13 between competition in journey growth and yield growth and that  
14 concludes that Hull Trains and Grand Central – and there is evidence  
15 of passenger growth and slow yield growth. So, I think it's clear when  
16 you look at all of the evidence of what's happened historically that  
17 there has been competitive response from the introduction of open  
18 access services.  
19  
20 THE CHAIR: Okay, thank you.  
21  
22 VTEC: Yes, so, just coming back on competition. It's clear from the CMA  
23 conclusions that there is effective competition today with the airlines.  
24 I'm just wondering –  
25  
26 ORR: Are you referring to the merger decision?  
27  
28 VTEC: Yes.  
29  
30 ORR: It is important to be quite clear what the legal basis for that merger  
31 decision is. It's that there is no substantial lessening of competition. I  
32 went back and read the references. I don't think they've said that  
33 there was effective competition. Not that they said that there's  
34 ineffective competition, either.  
35  
36 VTEC: Okay.  
37  
38 ORR: So, I think the issue of how strong airline competition is still to play for.  
39 I don't think the CMA is – it's just not written in its answer for that  
40 analysis.  
41  
42 VTEC: So, on the basis that there is competition, I'd just like to understand:  
43 Does the model include some airline fares?  
44  
45 CH2M HILL: So, the model that we use in the air market overlay, which looks at  
46 fares competition between rail, and in terms of fares, we included a  
47 cost that's a proxy for airline fares.

1  
2 VTEC: And then in the context of the competitor response discussion, what  
3 assumption have you made in terms of the response that the airlines  
4 will make to FirstGroup's cheaper fares?  
5  
6 CH2M HILL: ORR gave us some specific instructions on what to include on that  
7 airline competitive response and they're documented with our report.  
8  
9 ORR: So, just to add to that, we looked at that issue and we saw, just as you  
10 talked about earlier, that there are lots and lots of airline services and  
11 their fares are – some of the fares are very much lower than being  
12 offered by rail and we thought it was reasonable that airlines would not  
13 lower their fares in response to the FirstGroup service.  
14  
15 THE CHAIR: I can see it's going to be tricky to move this one on. I'll bring in Andy  
16 first –  
17  
18 VTEC: Yes, we've talked a lot about whether or not there'll be a competitive  
19 response and how to model it. I think we need to really look at the  
20 results that come out on competitive response because there's this  
21 concept of negative abstraction that comes out in the report and  
22 makes a fundamental difference to the NPA ratio. I mean it's just  
23 beyond comprehension. I can understand that there'll be a bit of  
24 reduction of that abstraction from a competitive response but not a  
25 negative. It just doesn't make sense.  
26 And the other thing to say is that when you look at the  
27 difference between the different sensitivities that CH2M Hill run, what  
28 you get is effectively an implied demand elasticity to price of minus  
29 two, which is roughly double what you'd normally expect in our  
30 industry which suggests that the model has well and truly been taken  
31 beyond the bounds of what is possible to model accurately using  
32 PDFH because these numbers are incredible.  
33  
34 THE CHAIR: Right, we're going to give Chris a chance to come back on that  
35 response and we'll listen to Russell's point and then I'm going to give  
36 Chris Hemsley a chance to make a final point. Then I am going to be  
37 moving on to the next section.  
38  
39 FIRSTGROUP: It's a point relating to whether or not there's scope for a competitive  
40 response. Obviously, time has moved on since the application. We  
41 put our application in a year ago. And actually during that time we've  
42 done some analysis and research on available information and having  
43 looked at the average fare over a four-month period – the same period  
44 following the franchise change with VTEC and today – so, during the  
45 same four-month period – the average fare of London to Edinburgh  
46 offered by VTEC had gone up by 7.5%. It's gone up by 9% to  
47 Newcastle. So, the proposition that we had to start with is now that



1 much lower than VTEC's is now. And we would argue that in fact  
2 provides scope for a competitive response from VTEC with its fares as  
3 it is now because its fares are now higher than they were before –  
4 without any competition.

5  
6 THE CHAIR: Ok, thank you. Chris Judge, do you want to come back on Andy's  
7 point?

8  
9 CH2M HILL: I think the accusation was some kind of error, from Andy. We haven't  
10 seen the base data that supports the calculations in VTEC's response  
11 to ORR so we can't replicate the calculations but it looks to us as if it  
12 doesn't follow the PDFH methodology and therefore we believe it has  
13 been completed in error but until we see the data that sits behind it, we  
14 can't possibly comment on it.

15  
16 VTEC: I don't think I'm saying it's an error. I'm saying that you've probably  
17 applied it perfectly right but maybe you've misclassified some of the  
18 demand. But the result is implausible so, whether or not it's in error, it's  
19 not credible. If it was credible, we would be out there in the market  
20 reducing our fares now. If we were a rational operator, we could  
21 compete with ourselves to bring the price down and have lots more  
22 lovely demand. And as a rational operator, that's what we would do in  
23 the base case. And that should be taken into account of in the base  
24 case, not as part of the option.

25  
26 CH2M HILL: Andy, you've previously stated to us that you can't reduce your fares  
27 because you're overcrowded. And, just, again, to make the same  
28 point, our elasticities are from PDFH inputs and outputs and our work  
29 has been independently audited. The methodology has been audited.  
30 The calculations have been audited.

31  
32 THE CHAIR: Right, those points are similar to the ones we've had before of the  
33 modelling versus perceptions of the outcomes of the modelling. I'm  
34 going to stop us there. Are there any further points you'd like to make,  
35 Chris?

36  
37 ORR: I think it's just worth making one more point, because we've talked a  
38 lot about the modelling. I think it's just a point that Simon made earlier  
39 that I think we need to step back here and make sure that people are  
40 giving us a consistent story about how they think competition works  
41 today and how competition will work post-entry. And I'm not quite sure  
42 that I've got that clear understanding in my head. I think it would be  
43 helpful if people could explain to us how they see the market operating  
44 today and the impact that entry have. I think it's worth people being  
45 really clear think about what impact they think a new rail service will  
46 have on pricing, on passenger switching and also fares policies. My  
47 understanding is you have dynamic pricing – so if you lose passengers

1 in the airline sector, prices automatically fall. That's what happens.  
2 So, I think it would be really helpful if you could explain in a narrative  
3 form how they see entry playing out in terms of effects, using that kind  
4 of competition language. We've got the modelling. I think we've got  
5 all the evidence on the modelling. I think we just want, in as plain  
6 English as possible, how you see that competition playing out.  
7

8 THE CHAIR: Right. Okay. I apologise, I'm going to move on at that point. Just  
9 following through Chris's earlier structure, we've now reached air  
10 competition.  
11

12 ORR: Yes, on the air competition overlay I don't think we have a particular  
13 need to talk about this any further. We've talked about the more  
14 general issue of air competition quite a lot already so I think there is  
15 more if it's a specific issue that CH2M and Systra just pick up relating  
16 to the checks that have been carried out on the model itself.  
17

18 THE CHAIR: So, this is in relation to specific questions that people have raised,  
19 wasn't it?  
20

21 ORR: Yes.  
22

23 CH2M HILL: So, if you could give probably 20 seconds on the model itself and then  
24 invite Systra to comment on the checks that they made. So, the model  
25 uses an approach that's recommended in the PDFH, which is  
26 commensurate with the available data to us. The logit model which is  
27 the approach uses reasonable component costs and parameter  
28 values. It's calibrated using the CAA data and national passenger  
29 survey data. Nothing more to add than it was reviewed as part of our  
30 full modelling suite.  
31

32 THE CHAIR: John?  
33

34 SYSTRA: Just a short statement. Effectively, yes, the first stage of it is the  
35 journey time competition with air which uses the well-documented  
36 PDFH approach. Perhaps not as well-documented as it should be but  
37 it's a PDFH-compliant approach. And, yes, we checked that  
38 thoroughly. The fares element isn't in the PDFH and requires an  
39 alternative approach. We looked at the generalised cost logit choice  
40 model that CH2M developed. The whole approach seems sensible.  
41 We did not look at the individual data behind the calibration but we did  
42 look at the resulting parameter values and confirmed that they appear  
43 to be fair and time parameters that were consistent and the applied  
44 elasticities were plausible. And we have audited the model and its  
45 detailed processes.  
46

47 THE CHAIR: Ok, thank you. Does anyone want to –

1  
2 VTEC: Can I just ask, is there anything you've heard today that makes you  
3 want to go back and just think about your audit again?  
4  
5 SYSTRA: Are you specifically asking about the air competition overlay?  
6  
7 VTEC: I'm thinking about your audit report in general I suppose, as we're half  
8 way through the section.  
9  
10 THE CHAIR: I think that would be an issue for us but I don't mind John giving a  
11 view.  
12  
13 SYSTRA: Well, it's clearly an issue for ORR if they want us to look at anything  
14 again. And if, I think it's actually an issue for CH2 whether they think  
15 that elements that they wish to change. And if they wish to change  
16 some elements, then we will look at what they change and say  
17 whether we agree with their change. And indeed, it's actually been a  
18 collaborative audit, so we might discuss it between ourselves. There's  
19 certainly, when we're talking about the air competition, there's nothing  
20 I've heard – well, we haven't heard anything really – which would  
21 make me want to change at all in that area.  
22  
23 THE CHAIR: Ok. Thank you. Any points in this area? Simon?  
24  
25 ALLIANCE: Not on the journey time issue. I think the way that has been modelled  
26 is not quite how I think we would suggest is ideal. But I think it's  
27 reasonable. In relation to fares, as we've been saying consistently  
28 since last June, there is a major issue of transparency here. None of  
29 the applicants except for FirstGroup who created the model in the first  
30 place have seen this model so there is a serious issue of  
31 transparency. And I think that's the point that both VTEC and DfT  
32 have made. And we just don't know whether it produces consistent  
33 results. An easy sensitivity test that could be done which would either  
34 increase confidence or not, depending on the result, would be to put  
35 into the generalised cost model that's been used for fare competition,  
36 for example, the journey time in the Alliance application, and see if it  
37 produced a similar change in the market. If it does, then we can be  
38 confident that the model works in a sensible way. If it doesn't, then it  
39 raises an issue that ought to be considered by everybody.  
40  
41 THE CHAIR: Ok, thank you. Do you want to come back?  
42  
43 CH2M HILL: Just a very brief response. The model's calibrated to current load  
44 shares.  
45  
46 ALLIANCE: Yes, but it doesn't necessarily have elasticity to generalised costs  
47 which are consistent with the PDFH curve.

1  
2 CH2M HILL: The PDFH curve is, so, if we're talking specifically about the fares  
3 element of the model, the PDFH curve is with respect to journey time  
4 and not with respect to fare.  
5  
6 ALLIANCE: Yes, I know but you've got a generalised, I'm sorry to – I'm just trying  
7 to get this clear – as I understand the model that you've used for fares  
8 competition in the airline market works on generalised costs. And  
9 what you do is, if you have an operator with a lower fare, you reduce  
10 the generalised cost by an appropriate amount and you see the effect  
11 that has on market shares in the market. Given it's a generalised cost  
12 model, you could, equally well, reduce the generalised cost by the  
13 equivalent number of generalised cost minutes and see if that  
14 produces a similar change to what the PDFH curve does. If it does,  
15 fine. If it doesn't, it raises questions about the model.  
16  
17 THE CHAIR: Shall we come back to that? Let's have a think about that and come  
18 back to that. We'll talk about that one afterwards. Let me bring,  
19 Russell, did you have a point to make?  
20  
21 FIRSTGROUP: Yes. All I was going to say about the air rail model is, yes, we've  
22 provided some information and we've provided that under a  
23 confidentiality agreement with CH2M and as we've just heard the  
24 report's been independently audited in a collaborative way but it has  
25 been audited. If it's helpful, clearly, and you would expect me to say  
26 this, and I would say this, the model that we had when we first  
27 produced it for our business case and our business model that we  
28 provided to the ORR is ours and it's commercially confidential but we  
29 would have no issue with, if it's helpful, with Systra, providing under an  
30 NDA, to review it as well. And CH2M Hill have got the same access  
31 so we're assuming that as a result of the independent audit it has  
32 already had that treatment but we would be happy to provide it.  
33  
34 THE CHAIR: Let's reflect on that then. I'd like to discuss that with colleagues, I  
35 think. Okay. Are there any other points on this overlay air  
36 competition?  
37  
38 VTEC: Yes, I think it's important to note a number of technical concerns we  
39 have specifically with the fares part of this overlay. I understand what  
40 John said when he said that within the scope of the audit he has  
41 looked at the outputs, the model, he's looked at the elasticities, and I  
42 think your words were that they appear 'sensible' or that they appear  
43 'plausible'. With logit models it's important to bear in mind that  
44 appearing sensible and appearing plausible is no guarantee that it's an  
45 effective model especially when it's only been calibrated against two  
46 specific examples where there is also uncertainty about the GJT effect.  
47 Systra have been unable to verify the problem in the source data due

1 to confidentiality restrictions although that may also be an issue that  
2 your point made but also we are concerned that the airfares that are  
3 an input to the model are estimated from airline websites. That is not  
4 an accurate way of calculating the average yield of airline fares.

5 Secondly, access and egress costs have not been included.  
6 The times have, but access and egress costs have not been included.  
7 Real car parking costs do not appear to be factored into account in the  
8 model. No mention is made of quantifying an average trip length  
9 which is an important determinant of overall car parking costs. And as  
10 I have mentioned before, the model has only been calibrated based on  
11 Newcastle and Edinburgh, and there is no mention of validation of the  
12 approach being undertaken on other routes.

13 Now, the overall point I am trying to make is that with this logit  
14 model, there will be a high degree of sensitivity to very small changes  
15 in input and so therefore there is huge uncertainty, particularly given  
16 these flaws, over the output.

17  
18 THE CHAIR:

19 Okay, thank you. I think we'll probably just have to register these  
20 points now, at this stage, given the time. So, unless there's anything  
21 else anybody wants to put on the record about that particular air  
22 competition overlay, I was going to move us on to the next area which  
23 will be the gravity model.

24 ORR:

25 Okay, so the main issue in terms of the comments that we've made  
26 around this area, relate particularly to the views on the suitability of the  
27 gravity model. Again, there's lots of material that's been set out about  
28 the detailed assumptions and again I'd urge you not to repeat those  
29 here. They have been set out so we can pick that out then. But I think  
30 it is worth making a couple of observations before we do take some  
31 comments on the gravity model.

32 We have reviewed the arguments that have been set out on  
33 the suitability of the gravity model as an approach. In principle, we find  
34 these arguments more informative than debates around precisely what  
35 WebTAG and PDFH say. This is all clearly set out. We don't need to  
36 rehearse those arguments here today.

37 Further, I think it's useful to emphasise here that the real issue  
38 as we see it is whether the gravity model adds anything to the  
39 evidence base or not. I don't think anyone is arguing that the gravity  
40 model is a perfect model. Neither are the alternatives. Rather, it has a  
41 set of advantages and disadvantages, much like MOIRA does. And I  
42 think all parties have set out their views on what those advantages and  
43 disadvantages are. I think in the interests of time; we should focus our  
44 questions around two things. One is I think it will be useful if people  
45 have this view, to set out whether they think that the gravity model  
46 adds nothing to the evidence base or whether it is right for me to  
47 characterise the debate as around how much weight to place on it.

The second one, I think, is a debate around the specific

1 circumstances where the gravity model may perform less well. So, are  
2 there particular locations, particular circumstances, where we think  
3 that the gravity model might perform less well. Those are two areas  
4 where we could have a more fruitful discussion rather than rehearsing  
5 the debates that I think are all well set out previously.  
6

7 THE CHAIR: Ok, thank you, Chris. Who anyone like to come back on those two  
8 questions?  
9

10 FIRSTGROUP: I'll just go first for a change. And this is in the context of the FirstGroup  
11 application rather than the other applications. So, the application of  
12 the gravity model is one way to approach the process problem. There  
13 are different demand models that could be used. And there's also a  
14 very simple bit of analysis that could be used by anyone to assess the  
15 demand uplift, which is trip rate modelling. And we didn't use a gravity  
16 model for Morpeth when we assessed the case for Morpeth but using  
17 the alternative approach to the gravity model and taking into account  
18 the catchment area and abstraction we came up with a very similar  
19 result to the gravity model that CH2M Hill produced. So, I think, in  
20 principle, we don't have any objection to the application of the gravity  
21 model in the specific situation of a location like Morpeth.  
22

23 THE CHAIR: Thank you. Simon?  
24

25 ALLIANCE: I think the most important point is to recognise that PDFH doesn't fully  
26 reflect the changes in the market that will occur when towns get a new  
27 through service to London or a radical enhancement to their service.  
28 Whether it's a transformational change or new journey opportunities,  
29 PDFH explicitly isn't applicable in those circumstances. It's referenced  
30 several times in PDFH that it's not really applicable where there's more  
31 than a 20% change in generalised journey time. There are also  
32 debates around the effect of interchange and so on which have been  
33 considered at some length. Clearly, there are a number of ways that  
34 one can look at this. The gravity model is one. The station choice and  
35 growth model that John Segal developed in 2009 for ORR is another.  
36 There are other approaches that one could use. But, I think it's  
37 important to emphasise that this should be a significant part of the  
38 decision making process. So, I think that answers the first part of  
39 Chris's question.  
40

41 In relation to the second half, I think we don't have any  
42 particular concerns about the application of the model and the effects  
43 that it has and we agree with the point that in most cases the amount  
44 of overlap with existing services is relatively small and therefore the  
45 gravity model is a reasonable tool.

46 The one place where we don't think that that is the case is  
47 Middlesbrough because Eaglescliffe, the existing Grand Central  
service at Eaglescliffe, and the proposed VTEC service at

1 Middlesbrough, are serving, effectively, the same catchment area.  
2 They're both serving the Greater Middlesbrough / Redcar type area.  
3 Grand Central draws its demand at Eaglescliffe from across that area.  
4 VTEC will draw again from across that area. Clearly, Eaglescliffe will  
5 have a greater advantage in the immediate vicinity of Eaglescliffe.  
6 VTEC will have a greater advantage in the immediate vicinity of  
7 Middlesbrough. But given the nature of the highway network in  
8 practice the two are competing at the same catchment area. And in  
9 that circumstance, we think the gravity model isn't appropriate – and  
10 trying to find hermetically sealed catchment areas doesn't work well.

11  
12 THE CHAIR: Thank you.

13  
14 SDG: I was going to go on the general approach and I think you're probably  
15 going to go into a bit of detail about areas of abstraction.

16 I think first of all we don't consider that there is a need for  
17 something above PDFH. We've set that out. I won't rehearse those  
18 arguments again, as you requested. But I do think it's important to  
19 note that PDFH 5.1 has significantly higher GJT elasticities than  
20 previous versions of PDFH. So, the situation is different in the base  
21 case. The GJT elasticities are 50% higher so even if previously there  
22 could have been an argument around the gravity model we think that  
23 it's in a different position now and in fact the recommendations in  
24 PDFH about whether you would need to have something separate for  
25 large changes in GJT also changed between those two versions. So, I  
26 just wanted to flag that.

27 We also have issues with the kind of form of the model chosen  
28 and how it works. So, effectively, the model is implicitly assuming that  
29 subject to population size and wage, the changes in the size of the  
30 number of journeys are related to the GJT we have between an Origin  
31 / Destination pair. I think this is conflating cause and effect because  
32 the rail industry has developed over a number of years the train  
33 service it offers and so operators will have put on good services with a  
34 low GJT to markets that are strong, where there's a strong underlying  
35 demand that isn't picked up in the three variables in the gravity model.  
36 So, I think there's something underpinning that that really needs to be  
37 understood and I think it would be overstating the GJT elasticity  
38 because it's not fully gathering that information together. So, it's  
39 saying that – I'm sure VTEC will say this – that they put the best  
40 service on to their strongest markets, I assume? And others have  
41 done that historically.

42  
43 THE CHAIR: Ok, thank you. Let's bring Andy in.

44  
45 VTEC: I think there are two issues here. One about where it's appropriate to  
46 apply an additional model and secondly about what additional model to  
47 apply.

1 I think in all the situations we regard a gravity model as  
2 inappropriate because a gravity model cannot model the abstraction.  
3 It has to be an overlay to the gravity model as I understand it. I know  
4 CH2M have done some of that now since last summer but we still think  
5 it is woefully inadequate. If you look at our current demand for places  
6 like Leeds, it's widespread across the entire area there that East  
7 Leeds Parkway would serve so we think that the abstraction is  
8 underestimated by more than a factor of two – at East Leeds Parkway,  
9 probably at some other stations.

10 I think Simon's point about not applying an additional model, (I  
11 wouldn't argue for a gravity model but an additional model) at  
12 Middlesbrough is slightly perverse. Eaglescliffe vs Middlesbrough is  
13 very similar to East Leeds Parkway vs Leeds. So, if it's one, it's got to  
14 be the other, surely. They are very similar – we don't even know  
15 where East Leeds Parkway is going to be yet, of course, but they're  
16 probably a very similar distance apart. They serve the same roles.

17 So, I think that's the two points. One is never a gravity model  
18 but in some cases an additional model I'd accept but if you're going to  
19 do it, Middlesbrough and East Leeds Parkway are similar, and they  
20 should be treated in the same way. And one thing that comes out of  
21 the gravity model is that Middlesbrough, which is a large city of about  
22 130 to 140,000 people gets half the increase, uplift in demand, than  
23 Morpeth does, which is a small northern town of 14,000. Okay, with a  
24 big catchment area, but so has Middlesbrough.

25  
26 THE CHAIR: Ok, thank you. Do you want to come back to all that, Chris?

27  
28 CH2M HILL: I will respond, I will just try and raise new points rather than –

29  
30 THE CHAIR: Yes.

31  
32 CH2M HILL: So, in terms of the catchment area analysis, a couple of things, we  
33 based our analysis on true origin data of passengers provided by  
34 VTEC. So, for example, in the case of East Leeds Parkway, we have,  
35 I hope, a good understanding of where VTEC's current passengers  
36 live, whether they access the network at Leeds or at York or some  
37 other location. We asked Grand Central for the same information  
38 specifically relating to Eaglescliffe and Grand Central said that they  
39 didn't have that information available, so the assessment at  
40 Middlesbrough is necessarily based on a combination of catchment  
41 populations, drive times to Eaglescliffe and to Middlesbrough and also  
42 the implied catchment areas of stations of similar characteristics. So,  
43 we had to do that.

44 Just reflecting more generally on the gravity model, just to take  
45 a step back, we used this approach not just because PDFH says it is a  
46 legitimate approach to deal with this problem but also because other  
47 industry parties had used this approach previously. For example,



1 Network Rail in its 2010 addendum to the East Coast Main Line Route  
2 Utilisation Strategy used a gravity model to address similar types of  
3 problems. When we devised this approach we looked in the  
4 consultation responses to that and both DfT and Virgin Rail Group  
5 submitted a consultation response which was silent on the use of the  
6 gravity model. So, we naturally assumed that they would be fine with it  
7 this time around –  
8

9 VTEC: Sorry. The Virgin Rail Group isn't a party to this application.

10  
11 CH2M HILL: At the time.

12  
13 VTEC: Just to clarify, we're not part of Virgin Rail Group.

14  
15 CH2M HILL: Simply, the operator of the West Coast Main Line or the parent group  
16 of the West Coast Main Line franchisee at the time.

17  
18 VTEC: Separate party.

19  
20 CH2M HILL: Ok. Just so we get a feel for similar organisations. So, we felt it was a  
21 reasonable thing to do.

22  
23 DFT: There was a reference to us there. Can I make clear that you can't  
24 extrapolate from our silence in response to a Network Rail consultation  
25 about something else, years ago, what our view on gravity models is. I  
26 think that's a completely ridiculous conclusion to draw.  
27 Also, on the point about PDFH – I understand from Lucy this  
28 recommendation isn't in line with PDFH, using gravity model isn't in  
29 line with the likes of PDFH –  
30

31 SDG: Yes.

32  
33 DFT: And I think we need some consistency here on the previous point  
34 around fares modelling, you were suggesting you should use a PDFH  
35 model, even though it was transparently producing nonsensical  
36 results. But here we're ignoring that PDFH recommends that we don't  
37 use the gravity model. This seems quite inconsistent.

38  
39 CH2M HILL: PDFH absolutely recommends it, that you use a gravity model in this  
40 context. It absolutely recommends that. I don't see there's much point  
41 in us having the argument because of our remit but even if you didn't  
42 believe me as a former Deputy Chair of PDFH or John, who's  
43 reviewed our work as an editor of PDFH – you can read it.

44  
45 THE CHAIR: Ok, thanks. We'll stop. I've noticed some very different views on what  
46 PDFH is saying among the people who are practitioners and indeed  
47 experts on PDFH so it's clear there's a very big difference of views on

1 that.

2 Just a little bit conscious of time. I know people have got a lot  
3 of things to say. Apologies. But, we are, you'll be staggered to know  
4 now, running a bit behind schedule so what I'm going to suggest is that  
5 we stop for lunch now. We come back at 1.45 p.m., as previously set  
6 out, 1.45 p.m., we then continue doing the crowding model which we  
7 haven't had time to finish yet. And then carry on as before.  
8

9 **The meeting adjourned at 1.08 p.m. until 1.45 p.m.**

10  
11 THE CHAIR:

12 So, we had one bit of unfinished business from the pre-lunch session  
13 that we're now going to pick up on which was the crowding model.  
14 We're going to do this in two parts. We'll do the forecast crowding  
15 impacts associated with some of VTEC's proposed services. And talk  
16 about the implications of the FirstGroup business model for crowding.  
17 And I think for the first one, we're going to hand straight over to Chris  
18 Judge, aren't we? And then we will come to Chris Hemsley for the  
19 second one.

20 CH2M HILL:

21 So, reflecting on a number of the responses received by stakeholders,  
22 there have been questions raised as to why in our assessment some  
23 of VTEC's smaller service enhancements have fairly large crowding  
24 impacts relative to the scale of the revenue impact as given by the  
25 options. This is specifically in relation to options 4, 5 and 6 which have  
26 all been modelled as increments of VTEC's core timetables. So, in our  
27 modelling suite, positive crowding impacts have been shown to occur  
28 where the timetable changes have encouraged passengers to switch  
29 to less crowded trains. And negative crowding impacts have occurred  
30 where timetable changes have caused train loads to be less well  
31 distributed than previously. For all three options, whilst the level of  
32 revenue from overcrowding is significant in terms of the forecast  
33 revenue generation for the option, the impact is small in terms of  
34 VTEC's overall revenue.

35 I'd just like to state that the crowding model we have used to  
36 develop this assessment is an off the shelf crowding model that's been  
37 used in a number of different industry applications before. It's been  
38 audited on a number of occasions before. I also point out that our  
39 report is clear, that our terms of reference to ORR do not include  
40 timetable validation. And we go on to state in our report that our  
41 assessment does not capture the benefits of network optimisation fully.  
42 We also state that whilst this is true of all options, it's most likely to  
43 affect some of the VTEC options which are significant changes to the  
44 current timetable.

45 THE CHAIR:

46 Ok? Thank you. Did anybody want to come in on any of those points?  
47 Andy?

1 VTEC: I think our main concern is the Middlesbrough option which we  
2 specifically designed – well, it was really a 50 / 50 in the business  
3 case. Part of it was to solve crowding problems that we had in our  
4 core, part of it was to serve Middlesbrough. And we've actually  
5 specifically designed the service to bring in five extra train sets; three  
6 of which are basically used to serve Middlesbrough and the other two  
7 of which are to strengthen services elsewhere. So, the idea that that  
8 can make crowding worse is, well, incredible to us. And I think it must  
9 be somehow we've found our train sets being mis-allocated in the  
10 CH2M crowding model. That is maybe our fault, maybe not. I don't  
11 know but the results do seem incredible.

12  
13 THE CHAIR: Ok. Anybody else? No? Okay. Anything you want to add, Chris?

14  
15 CH2M HILL: We have investigated this; we didn't detect much of a crowding  
16 problem on Leeds services. We actually felt that the stock allocation  
17 that we modelled – your stock allocation is pretty good for introduction  
18 of the Middlesbrough service, we detected problems, some problems  
19 with moving station calls between services at York and Peterborough.  
20 I think it is, reflecting on the advice we've given to ORR in our report, I  
21 think it possibly is likely that a franchise operator with the ability to  
22 switch calls could solve this in the future. So, perhaps our advice  
23 should have gone a little further and said to ORR maybe you wish to  
24 consider a scenario where there isn't a crowding dis-benefit in the  
25 Middlesbrough option, given what I've just said. But, the model itself  
26 seems to be working perfectly well.

27  
28 DFT: Again, I think our general point to ORR is we can't understand how this  
29 result has occurred and without looking into CH2M Hill's model, which  
30 we don't have the option of doing, it's not possible for us to verify. But,  
31 again, we just have to think: is it credible? Is it credible that you run  
32 additional trains and put on additional rolling stock and therefore  
33 crowding gets worse? Clearly, it isn't. Clearly, something is wrong.  
34 We can't verify what it is but clearly the result as produced is  
35 incredible. It could be a problem with the model. It could be that the  
36 rolling stock allocation that's been tested isn't appropriate because the  
37 franchise operator has the option of running some five car IEPs, some  
38 nine cars, some five plus five – so, yes, lots of different things can be  
39 done. It can change its stopping patterns. So, either there's a  
40 problem with the model or there's a problem with the rolling stock  
41 allocations, or with stopping patterns, that the franchise operator  
42 clearly would change. So, as presented, the results for this model are  
43 clearly not credible or representative.

44  
45 ALLIANCE: Can I just quickly come in on that? I haven't got the facts and figures  
46 in front of me but as I recall the Middlesbrough option depends on  
47 changes to stopping patterns to Edinburgh. Is that correct?

1  
2 CH2M HILL: That's correct.  
3  
4 ALLIANCE: Yes. So, is that not where the crowding impacts have come? It's not  
5 so much directly on the Middlesbrough service, although there may be  
6 additional factors coming from Middlesbrough. It's the way that those  
7 stopping patterns will – and the fact that you're using the  
8 Middlesbrough option to actually speed up the Edinburgh service.  
9  
10 VTEC: I think that is possibly how it's come about in the modelling. The point  
11 is if we've got more rolling stock on the table in general, even if the  
12 initial application of it turns out to have slightly more crowding, we'd  
13 have more rolling stock available to resolve it very quickly and make  
14 sure that crowding was less than the previous option. You never know  
15 exactly how it's going to land when you introduce a new timetable but  
16 having more rolling stock there to enable you to relieve crowding is a  
17 good thing, not a bad thing.  
18  
19 ALLIANCE: That option depends on using loco-hauled coaches.  
20  
21 CH2M HILL: In the context of CH2M's work, I think I've just agreed with Andy here,  
22 having viewed the responses, we think it is probably reasonable that a  
23 franchise operator will be able to sort this out from redistributing either  
24 with rolling stock across a day or its stock capacity across the day.  
25 So, I've responded to that.  
26  
27 DFT: Sorry. Can I add to that?  
28  
29 THE CHAIR: Yes.  
30  
31 DFT: That means that results you're currently reporting for this option aren't  
32 representative and so shouldn't be the basis of any consideration of  
33 that option.  
34  
35 THE CHAIR: Thank you. I think we should move on. Can we just go over to  
36 FirstGroup now?  
37  
38 ORR: First has set out its business proposition that they have in terms of the  
39 relationship between your model for booking seats, and not having  
40 significant people standing. I think that does affect how we view  
41 crowding dis-benefits in that some of the effects, such as the stress  
42 that you won't get a seat, those affects wouldn't likely be seen in the  
43 same order of magnitude, given the majority of passengers have a  
44 seat reservation.  
45 So, that's really the only thing we have to talk about because  
46 we've talked about the substance of what you're offering. So unless  
47 anybody's got anything to say?

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THE CHAIR:

I feel that we've gone through that in quite a bit of detail. I was hoping prior to lunch that we wouldn't need to do this anymore. Is everyone happy with that? Okay. Shall we move on now – so, we're back on now the post-lunch agenda which was the specific impacts on parties. And one of the things we just wanted to go through here was the impact on the Secretary of State of some of the options. And indeed DfT circulated some numbers two days ago I think on this. There have already been some responses. Can I invite DfT just to summarise your issues and concerns around the impact on the Secretary of State?

DFT:

Ok. We circulated the numbers. Clearly, the impacts of the options on the Secretary of State depend on what scenarios are assumed for both what the open access service is and then what VTEC can still run. So, the results will be very sensitive to that. And I think we would repeat the offer we made to ORR in the past, that if there are specific other scenarios they would like us to test, then we can do that.

The scenarios we're presenting here were those modelled in the SDG appraisal which in turn was selected to be consistent with what ORR told us that CH2M Hill was going to model so that's how we've selected these scenarios. But if you tell us there are other things you'd like us to model we can test that.

So, in all cases we've assumed that VTEC can still run the accelerated 2014 timetable, which we refer to as the 2014 speeds timetable. That, as per what we understood that CH2M were assuming, in those scenarios, the financial impact on the Secretary of State measured over the remainder of the VTEC terms, so that's between May 2020 and March 2023, and then up until 2033, the average per year real impact on the Secretary of State for the Alliance Edinburgh option was £132 million and that's comparing against the 2014 timetable. Once you take into account that if this stops VTEC operating the six times an hour core timetable, the impact increases to £183 million per year. For the Alliance West Yorkshire / Cleethorpes service, the impacts respectively are £64 and £115 million per year. And for the FirstGroup Edinburgh services the impacts are respectively £52 and £103 million per year.

We've heard from Network Rail that – well, we heard from the capacity discussion at the start – that additional capacity might only be available from May 2021 onwards and not May 2020, as we'd heard. That was new information to us in this meeting. If the additional capacity and the open access services started in 2021, as opposed to 2020, the per year impacts would be on the Secretary of State would be slightly bigger. That is because during the franchise term, the financial impact is shared between the Department and the franchisee, whereas from the end of the term, in 2023, potentially less than two years after the additional services had started, obviously, the entire

1 impact would be borne by the Department. I think it's important to take  
2 into account also that these estimates do not take into account the full  
3 potential impact on the Secretary of State.

4 That impact reflects the premium that we can obtain from other  
5 franchise competitions, we think it's very likely that bidders for other  
6 long distance franchises would take into account if these highly  
7 abstractive open access applications were granted. And that would  
8 further damage the Department's financial position.

9 It's also important to emphasise that all of this would occur in an  
10 already challenging fiscal environment. DfT has to make some  
11 savings in its resource budget of 37% over the current spending  
12 review term. The spending review settlement is not set for the  
13 subsequent years as yet but it would appear unlikely at this stage that  
14 there will be a substantial increase in the budget available.

15 The savings to our resource budget have largely been  
16 accommodated on the basis of being able to make reasonable  
17 assumptions based on what's happened so far on the returns we can  
18 get from future rail franchise competitions which we think would be  
19 further at risk if these applications were granted.

20 I think we would also highlight that DfT's contribution to overall  
21 reducing the country's deficit means that it has relatively little flexibility  
22 to manage risks which might crystallise and the options to manage  
23 those risks may have to include cuts to non-committed elements of  
24 transport spending. The Department is likely to have to absorb a  
25 number of other financial risks, including those arising from delays and  
26 budget over runs on the Great Western Electrification Programme and  
27 consequent impacts on the Great Western and other franchises. So,  
28 those will already be testing DfT's ability to manage risks within its  
29 budget. So, this would be a significant additional impact on the  
30 Department which it has very limited scope to absorb.

31  
32 THE CHAIR: Thank you. Does anybody want to comment?

33  
34 FIRSTGROUP: I think I was a bit surprised that we were having a rehearsal of the  
35 email that was sent out yesterday given the comments that had been  
36 made previously about not going over ground that has already been  
37 established. But, fair enough. So that would mean that I would then  
38 reiterate the email that I sent yesterday in response to it. And I'm sure  
39 Ian is going to reiterate the points he made on his email that he  
40 responded with yesterday. So, conscious of saving time, I'm not going  
41 to rehearse all of those points but suffice to say, the analysis as  
42 presented, as we understand it, because it's quite limited because it's  
43 just an email with a table and a few words, seems to suggest that  
44 these are all scenarios where the SoSRA is triggered. Well, in the  
45 cases that have been discussed, and the capacity that's been talked  
46 about, that we talked about this morning, the SoSRA is only triggered if  
47 there are less than six paths.

1  
2 DFT: Can I correct that? Because as I'm sure Russell is aware, that isn't  
3 true. The SoSRA is triggered if the franchisee cannot operate two  
4 trains per hour to Edinburgh and three trains per hour to Newcastle.  
5 Even if it is possible for the franchisee to operate six trains per hour  
6 into Kings Cross, the SoSRA is quite likely to be triggered. ORR made  
7 a point this morning on capacity, that there were potentially two and a  
8 half paths an hour to Edinburgh. That was news to us and we hadn't  
9 taken into account because we were working on the basis as we  
10 understood from Network Rail's previous capacity analysis, there were  
11 two paths an hour to Edinburgh. But I think just to make the point –  
12 that's not what triggers the SoSRA.  
13 Also, I think the SoSRA is almost entirely irrelevant actually.  
14 The SoSRA applies to the current franchisee period, which covers less  
15 than two years of the period in which these open access services  
16 would operate. So, the allocation of revenue risk during that term,  
17 during that two years, may be slightly different depending on exactly  
18 what operates. But really, the vast bulk of the financial impact on the  
19 Secretary of State is beyond the current franchise term.  
20  
21 THE CHAIR: So, you say in terms of a future franchise value?  
22  
23 DFT: Yes.  
24  
25 FIRSTGROUP: So, John could I respond to that?  
26  
27 THE CHAIR: Yes.  
28  
29 FIRSTGROUP: It would be helpful, Simon, if the information, when it's circulated, is  
30 very clearly articulated as to what it is you're circulating. That very  
31 brief email did not allude to all of that information.  
32 And a couple of other points. Firstly, on the point around, you  
33 said it was 'consistent with the SDG' or with the SDG report. It said  
34 that there was seven and half paths not eight. So, that isn't consistent.  
35  
36 DFT: No. It was consistent with the scenarios that were modelled in the  
37 SDG report which are in turn consistent with the scenarios that were  
38 modelled by CH2M.  
39  
40 FIRSTGROUP: Okay. But, in your letters you've referred to seven and a half paths,  
41 not eight. So, it is a relevant point because in certain circumstances  
42 you could have a situation where the capacity is shared across routes.  
43 We could have a number of scenarios where there are six trains,  
44 including three to Newcastle and two to Edinburgh, and then there's  
45 another Edinburgh service and there's other services to West  
46 Yorkshire. It depends entirely on what you're looking at. So, I think  
47 just to present that small information is not particularly helpful.

1 And then to go back on your – I don't think I'll dwell too much on  
2 the other points that you've made in terms of – I'm trying to think of the  
3 better words to describe this – the way in which you've said that there  
4 are potential future implications on funding of the railway. I'm not  
5 entirely sure of the relevance of that in this situation particularly given  
6 that the previous reports that have been produced have demonstrated  
7 that when open access operates, there has been an increase in the  
8 service which generates overall economic benefit. But, suffice to say,  
9 as a bidder, because I think as most people understand, FirstGroup  
10 has more than just open access, we're bidding for franchises, we've  
11 recently won one. We continue to bid in and we assess when we're  
12 bidding who is there. I don't think as a result of having open access  
13 applications approved of one group or another group, that's going to  
14 materially change what we do in terms of our response to the bid. So  
15 I'm surprised about that.

16  
17 THE CHAIR: Ok, thank you. Can I bring in Ian?

18  
19 ALLIANCE: Thanks John. It is rather incredulous to believe that the impact on the  
20 Secretary of State would be more than the total amount of revenue  
21 that's generated by a new service group. So, as I asked Enrico in my  
22 email, sending it back, it would be quite nice to see some background  
23 work on that. In particular, how, now the SoSRA's not important,  
24 despite the fact it's been very important until today. Looks like VTEC's  
25 problem, it's nobody else's.

26 The issue in relation to impacts into the next franchise, the  
27 email that came also suggested there was an impact from 2020. That  
28 may have moved to 2021. Now, bearing in mind that, as you said,  
29 there's probably no impact on the SoSRA, that's clearly incorrect, so I  
30 don't know why we're being misled in that way because there cannot  
31 be any impact on the Secretary of State if the SoSRA's not impacted,  
32 and indeed, even if it was, it was potentially for a couple of years.

33 Simon also referred to the fact that there'd be a threat to  
34 bidding. Well, I would have thought anybody bidding for the East  
35 Coast Main Line and our colleagues at FirstGroup did bid for the East  
36 Coast Main Line, if you're ever going to be threatened, this was the  
37 time. Our applications have been there for two years, to run a very  
38 fast Edinburgh service and to run additional services into West  
39 Yorkshire and Cleethorpes. It didn't seem to put off the bidders. The  
40 ones that seem to put off the bidders are the ones where maybe it's  
41 tightly constrained and so Southwest trains, I understand, you've only  
42 got two bidders. But, there's no evidence that on long distance high  
43 speed that there's any reduction in appetite for people to try and seek  
44 to run these services.

45 In relation to the costs and I wasn't aware that we were partly  
46 responsible for potentially putting a threat to the whole economy, then,  
47 as Jonathan's pointed out earlier today, there have been ample



1 opportunity and offers for open access operators to get more involved  
2 in funding the network but DfT have taken every opportunity to prevent  
3 that from happening. And I can only put that down to the fact that you  
4 don't like the implications that open access responds only to its  
5 passengers and doesn't have to respond to the DfT and in effect this  
6 continual targeting of the best operators on the network doesn't do the  
7 DfT any favours in relation to what we're talking about.

8 So, overall, as I said in my email, the figures are fanciful; there's  
9 nothing behind it. I mean most of the figures for our supposed  
10 revenue are included in the public domain from Chris's report, by  
11 CH2M. So, it is, and you've used the word yourself, before, when  
12 we've talked about the report: it's incredulous to believe that the  
13 impact on the Secretary of State could be significantly many times  
14 more than the total revenue earned by an open access operator  
15 because that just doesn't make any sense because every piece of  
16 evidence you have – and again, Russell has mentioned it – is that  
17 open access operators drive up, and competition drives up usage of  
18 the network. And even though I don't believe there's no competitive  
19 response and that there's no evidence of any competitive response,  
20 we know that there clearly is. And so passengers benefit, as well as  
21 many others.

22 And it is quite intriguing that for all the downsides that you show  
23 about open access operators, that VTEC's application actually seeks  
24 to replicate the markets created by those open access operators at  
25 Sunderland, Teesside and West Yorkshire; markets that you've  
26 ignored in the past. And markets that now you seem to be suggesting  
27 will do nothing other than drive down the value of the entire business.  
28 Because, surely, if it's the same for an open access operator, running  
29 those services, the same must actually be said of the franchise  
30 operator running those services.

31 So, it really is, as you've said before, a stretch of the  
32 imagination too far to believe what you've said. There is not one shred  
33 of evidence that you can produce that would back that up. And as a  
34 final note, if you go back, historically, to where we were in 2005, when  
35 the ORR determined that applications for the East Coast at that time,  
36 there were about 130 paths. If Grand Central and Hull Trains had not  
37 challenged Railtrack and Network Rail at the time on its ability to use  
38 infrastructure wisely, we'd be talking here about use of the sixth path,  
39 not the eighth path. And so you need to give some value to what open  
40 access manages to do in relation to the infrastructure provided. And  
41 that's been highlighted by the CMA, and it's something that you need  
42 to take into account. This constant badgering with nonsense figures  
43 into the public domain doesn't do the DfT any justice. And it needs to  
44 sit back a little bit and think about the benefits that open access has  
45 brought and stop trying to protect its position with unrealistic  
46 assumptions, because that's all they are.

1 THE CHAIR: Ok. Thank you. Did you want to come back on any of those points,  
2 Simon? What I was going to say, just as a general point, if one of the  
3 things that come out, I think if there's any more detail about any of the  
4 assumptions underneath the figures, people will clearly find that  
5 helpful.  
6

7 DFT: I'm sure we could do that but then similarly, I would say to ORR, it  
8 could ask its consultants, CH2M, to estimate the financial impacts on  
9 the Secretary of State of the different scenarios it has tested. CH2M  
10 Hill's report doesn't report that. I would have thought they would have  
11 very easily been able to calculate it. I think one of the concerns that  
12 we've raised about CH2M Hill's report is it doesn't present its results in  
13 terms of benefit to cost ratios, which would be the normal way of  
14 presenting the results of an economic appraisal. We've had to present  
15 these numbers partly because ORR and its consultants have not done  
16 so.  
17 I'm slightly struggling on what Alliance have said because I  
18 didn't really get a clear question there for me to respond to, just  
19 complaining about the fact that the Department is concerned about the  
20 financial impact of open access services. Well, of course we are. I  
21 note again Alliance saying that they're happy to contribute towards the  
22 cost of the network but really the current charging structure is a matter  
23 for ORR. DfT has commented many times on the current structure of  
24 access charges and its concern about the fact that open access  
25 operators both don't pay anything towards the fixed cost of the network  
26 and receive very substantially discounted rates of capacity charge  
27 which is a really significant charge on the East Coast Main Line. But,  
28 these decisions have been a matter for ORR, not a matter for the DfT.  
29

30 THE CHAIR: Thank you.  
31

32 SDG: Just on a point of detail -  
33

34 THE CHAIR: Yes. Lucy then -  
35

36 SDG: I think both the last people mentioned, have been in agreement,  
37 there's eight paths. Am I understanding what you said at the  
38 beginning was there were definitely, probably, seven and a half, but  
39 there was significant doubt about eight?  
40

41 ORR: No, that's not what I said.  
42

43 SDG: Fine. Sorry. Apologies for that.  
44

45 ORR: There were various constraints and if each of those were met, then we  
46 could see a total of eight paths being allocatable. But we said that in  
47 allocating the final half, over and above seven and a half, we'd need to

1 be satisfied on issues such as connectivity.  
2  
3 SDG: Yes. Thank you.  
4  
5 THE CHAIR: Yes. Chris?  
6  
7 FIRSTGROUP: Thank you. Two points of principle. One in relation to the position  
8 during franchise. And the second, after franchise.  
9 In terms of the integrity of the bidding process, which is  
10 effectively one of the submissions, obviously what happens in a bid  
11 process is that tenderers are asked to bid a certain amount of premium  
12 for a certain amount of capacity against certain defined risks, one of  
13 which is open access risk.  
14 In terms of equality of process, if what is being then said is that  
15 to deliver that same amount of premium, one has to take a different  
16 view of the risk or that it then requires a different amount of capacity,  
17 that is essentially fundamental and affects the equality of the bid  
18 process. So that, in our submission, should be taken into account  
19 when looking at the respective submissions.  
20 In terms of the position post-franchise, we touched on this at the  
21 hearing in June. The starting point on arguments on impact after 2023  
22 assumes franchise ownership of all available rights. That June  
23 exchange involved a helpful confirmation given by the Department:  
24 that it wasn't their submission that there was effectively 'total  
25 ownership' to take as the starting point and as a basis for impact.  
26  
27 THE CHAIR: Thank you. Jonathan?  
28  
29 ALLIANCE: Just picking up on some of the points that Simon has made. Note that  
30 DfT is trying to make savings; has got issues over resourcing its  
31 budget; it's got a tight fiscal budget; where we are is we wanted to  
32 contribute to that and we keep saying this to DfT and unfortunately DfT  
33 doesn't take us up on the offer. So, on the one hand it sits there  
34 whinging about impact on Secretary of State's funds but on the other  
35 hand it isn't actually trying to resolve the issue. So, there is a pot of  
36 money here that can reduce that impact on the Secretary of State's  
37 funds. We'd like to ask the DfT if their willing to engage in constructive  
38 dialogue on that? That's one issue –  
39  
40 DFT: I need to say again, the charging structure is a matter for the ORR, it's  
41 not a matter for DfT –  
42  
43 THE CHAIR: Jonathan, is that the point you're making, or are you saying it's outside  
44 the charging structure?  
45  
46 ALLIANCE: Absolutely.  
47

1 THE CHAIR: Right. Okay. Just to try and clarify. Yes.  
2  
3 ALLIANCE: This is not just about the charging structure and we do want to engage  
4 with the DfT constructively. We did try and do this over two years ago.  
5 And we did have some good dialogue. We want to take it further. We  
6 want to reduce the burden on the taxpayer but you just sit there, using  
7 taxpayers' funds, saying that you're going to get the taxpayer to enter  
8 in to a SoSRA, why you've done that, I do not know, because the  
9 Public Accounts Committee criticised the DfT in respect of using  
10 taxpayers' funds for the IEP. That is a fact because – you can shake  
11 your head as much as you want. One of the issues you've mentioned  
12 about fixed access charges, you say that to develop an access doesn't  
13 make a contribution there. That is true. But that's the making of the  
14 DfT who pays subsidy and a court decided in 2005 that it would be  
15 illegal for us to pay that – for open access to pay the subsidy which  
16 you require through the fixed access charges. That is the law. It's the  
17 DfT's making. You continue to pay that subsidy. It's not the ORR. It's  
18 the DfT.  
19 And then there's the issue about the levy which we keep  
20 raising, which is Directive 2012/34. And this relates to how anybody  
21 can contribute to the provision of public service obligations and we'd  
22 like to do that but, again, we've approached the DfT, and it's missed  
23 the boat. So, I just want to know why the DfT doesn't want third party  
24 open access businesses contributing to the financing of the network to  
25 reduce the impact on the taxpayer?  
26  
27 THE CHAIR: I'll ask DfT in a minute if they want to come back, but just on that, we  
28 just have to hold that for a minute, while I just bring Andy in.  
29  
30 VTEC: Yes. I think firstly, just talk about the numbers from DfT and just to  
31 reiterate that once you adjust for the fact that the DfT numbers are in  
32 mid-2020 price and demand levels and all the other numbers we've  
33 talked about have been at current demand price levels and demand  
34 levels, we get very similar numbers to the DfT and I'm happy to share  
35 those with you. We have shared most of them with you and with some  
36 tweaks we will share those with the wider audience. We support those  
37 as being of the right order of magnitude. And that is obviously a large  
38 number, even in current money, we're talking about the best part of  
39 £50 million being taken out of the franchise per year for the least  
40 abstractive option on revenue. If you go back to Leigh Fisher – it's a  
41 range – but it suggests somewhere in the mid-40s as being taken out,  
42 by all the current open access on the East Coast Main Line. So, what  
43 we're talking about is the least damaging, of the current application as  
44 being more than everything put together so far, which is a major step  
45 to contemplate.  
46  
47 THE CHAIR: Ok, thank you. Unless DfT particularly want to come back anymore,

1 I'm assuming we've heard each other's view and we've noted those?  
2

3 HULL TRAINS:

4 It's very rare - I'm actually going to be supporting some things that the  
5 DfT have said but you might gather that there's going to be a catch.  
6 The issue of funds, as far as the DfT are concerned, I am involved with  
7 them on the Great Western issue at the moment and the potential  
8 downside to the DfT, to the whole rail budget, are considerable. But in  
9 terms of letting a franchise, especially on an inter-city franchise, it can't  
10 be right that your business assumption is there is no, or very little,  
11 open access competition. Certainly on the other side of the table,  
12 when you're bidding, it's something that is very, very big in terms of  
13 what you put in as your risk premium for open access. If the DfT  
14 because of its financial situation is forced to actually go down the route  
15 of assuming that so much of its revenue has to come from its  
16 franchised operator and therefore it must assume that there is hardly  
17 anything that goes off to an open access operator, I actually think  
18 that's a bad place to be because every main line in this country, as  
19 soon as you put capacity on it, will attract open access interest. And  
20 as far as open access operators not paying their fixed charge, I sat  
21 through five days of court hearing to discuss all of this. We pay what  
22 we're legally obliged to pay. We pay the same rate, the same suite of  
23 charges as the franchised operators pay, except for one thing – which  
24 is the franchise fixed track access charge which is a pass-through from  
25 government to Network Rail to satisfy the residual funding requirement  
26 of the infrastructure provider. It is an artificial construct. Currently, we  
27 pay a capacity charge set by the regulator in the last control period  
28 which is a mark-up on our current operations in terms of EU law.  
29 We're quite happy to do that at a price that the market can afford and it  
30 doesn't price us off the network, which is, again, the legal position. In  
31 the forthcoming Control Period, we fully expect that the fixed track  
32 access charge will be fully extinguished and it will be up to operators to  
33 pay a mark-up on their existing operations. And we expect to pay that.  
34 In fact, that is what I said with Adrian Campbell and Brian Kogan in this  
35 very building, a few years ago – that I want to pay the exact same  
36 money as Adrian's trains to go between London and Doncaster per  
37 path. And that's the way that this railway should operate and we  
38 should be looking at alternative ways of providing services through  
39 whatever mechanism is being explained that do not get you into the  
40 situation where you are forced to have to maximise the entire value of  
41 an investment through a franchise mechanism because that's the root  
42 of our problems. And please, you have to tie investment up with your  
43 track access applications so that we don't spend all of the money  
44 coming around the table every time we have an inter-city franchise  
45 award.

46 THE CHAIR:

47 Ok, thank you. I think there's a limit to how far we can go on some of  
those points about structure, given what we are here to discuss today.

1 So, I'm going to call a halt. My apologies. As we were talking there  
2 just about open access in general, I did want to talk a bit about the  
3 impact of the applications on current open access operators and  
4 whether any of the current open access operator wanted to make any  
5 points because of the impacts on them because it has come out of  
6 some of the work that we've seen?  
7

8 GRAND CENTRAL: Yes, there are some scenarios that may come out of the applications  
9 that have been submitted that would be pretty devastating for Grand  
10 Central as an existing successful open access operator on the  
11 network. And, at the current levels, I would go as far as to say that it  
12 would have a significant impact on our solvency. It has a wider impact  
13 as well as on the Grand Central business because obviously the  
14 markets that we've developed and the flows that we now serve and  
15 operate have generated a lot of jobs and wealth for the local economy  
16 which would also be affected by the lack of a local access service  
17 directly into the heart of that community. I think it's fair to say that  
18 competition has been very successful in the East Coast Main Line and  
19 if there was a decision made that would create a backwards step for  
20 competition and for open access on the East Coast Main Line that's an  
21 undesirable outcome, that I don't think anybody is particularly looking  
22 for. The CH2M Hill report acknowledges the fact that it would have a  
23 significant impact on open access operators and we obviously agree  
24 with that and we don't want to be in a position where there's an  
25 adverse outcome from this determination.  
26

27 THE CHAIR: So, you agree with the financial impacts as set out in the CH2M Hill  
28 report?  
29

30 GRAND CENTRAL: We think they're conservative but even at the modelled levels that that  
31 would make continuing to operate our current services very, very  
32 challenging.  
33

34 THE CHAIR: Ok, thank you.  
35

36 HULL TRAINS: Yes, not wishing to repeat exactly the same points as Grand Central,  
37 the potential effect of some of the new services on business are  
38 considerable but it appears the main effect is the VTEC timetable and  
39 if our trains are getting overtaken on every journey north and south.  
40 However, because the figures are conservative, the actual gain /loss  
41 equation really does depend on what comes out of the Events Steering  
42 Group (ESG) process. And we would like some guidance in the  
43 determination to Network Rail on the existing services both franchised  
44 and non-franchised, without fettering their overall discretion in terms of  
45 allocating capacity for best use, so that we can't be put at a huge  
46 disadvantage in the ESG process. So, what we're looking for is  
47 general guidance to Network Rail that we won't be adversely impacted

1 through the ESG process to such an extent that we have to cease  
2 operations.  
3

4 THE CHAIR: Right, just to be clear that guidance you think should come from?  
5

6 HULL TRAINS: As part of the determination process, but without fettering Network  
7 Rail's overall discretion and its duties to allocate capacity, so,  
8 effectively, not setting an agenda but setting an expectation.  
9

10 THE CHAIR: Right, thank you.  
11

12 GRAND CENTRAL: Can I just say, we've made that point to the ORR as well.  
13

14 THE CHAIR: Yes.  
15

16 GRAND CENTRAL: That the timetabling that would come on the back of any decision is  
17 absolutely critical to determine the financial impacts on open access  
18 operators.  
19

20 ORR: Can I just check then, are you saying the kind of guidance suggested  
21 by Andy would deal with your concern about, I think you said,  
22 potentially 'devastating impacts' of the VTEC proposal? Or would you  
23 want more?  
24

25 GRAND CENTRAL: Yes, I'm not going to say that it would satisfy us entirely but it would be  
26 very helpful.  
27

28 ORR: Ok, thank you.  
29

30 THE CHAIR: Thank you. Any points in terms of the impact on existing access?  
31

32 VTEC: I've heard what both Grand Central and Hull Trains have said. I would  
33 just say that revenue impacts apply to us as well. A pound is a pound  
34 and, yes, get the point that both Hull Trains and Grand Central are  
35 small businesses, but a pound is a pound, and it can have the same  
36 impact on each operator on the network, freight and other operators.  
37

38 THE CHAIR: Okay. Yes, Andy.  
39

40 HULL TRAINS: Yes, a pound is a pound but there is such a thing as fair competition  
41 and the draft timetable that was produced that we have sight of  
42 actually seemed to be produced to actually put existing operators at a  
43 competitive disadvantage for a particular purpose and we believe, in  
44 Hull Trains, that was done to maximise the revenue of the East Coast  
45 bid at the expense of the existing operators by moving trains, and  
46 overtaking trains. We don't want to see that happen. We've never  
47 been in that situation before where somebody has tried to effectively  
move us around the graph for their own particular advantage. The

1 ESG process should tease those issues out and deal with them. And  
2 that's why I've got more confidence in the ESG process, at the end of  
3 the day. But if somebody has got that level of competitive advantage  
4 during the ESG process then that really does start to affect the future  
5 of certain operators' businesses.  
6

7 THE CHAIR: Ok, thank you.  
8

9 ALLIANCE: Just to add a little bit to that in relation to competitive advantage.  
10 We're talking here about the monopoly operator, in monopolistic terms,  
11 on the route. In effect, having completely different access rights to the  
12 markets, the upstream market, and open access operators, that's why  
13 we're sat here today because, as it was said in court, they are chalk  
14 and cheese in terms of access to the market. So, although a pound is  
15 a pound, in relation to the development of new businesses, as you can  
16 see with VTEC's Sunderland service at the moment which gets into  
17 London in the peak, in the morning peak, it is impossible for a  
18 monopoly operator ever, ever to fail the NPA test. So, that's why they  
19 have such significant access to the upstream market in relation to an  
20 open access approach. So, if we're going to have a pound for a pound  
21 then we need to get rid of the anomalies within the upstream market,  
22 access to the market. And it's only in the downstream market where  
23 we're actually competitive, actually where everybody does work in a  
24 competitive environment. VTEC and people before them compete  
25 very heavily with Grand Central as Grand Central does, so, you're  
26 absolutely right. We like competition. It has to be fair competition and  
27 the difficulty we have is gaining access to the market because it does  
28 work as I'm really pleased that you're asking the question now, it does  
29 work both ways. But the monopolistic supplier has so many benefits  
30 which was identified in the court that for it to now be complaining –  
31 having made a bid knowing exactly what the potential competition was  
32 – is maybe a little bit rich.  
33

34 THE CHAIR: Ok, thank you.  
35

36 VTEC: A couple of points to make in terms of the overtaking move and the  
37 VTEC 2020 timetable of the Hull Trains, we've dealt with that in  
38 industry consultation and we have in response said that we'd expect  
39 the timetable development process and ESG process to resolve the  
40 situation. And so we don't expect that to be an issue when it comes to  
41 the actual timetable. There are different ways to get to the market that  
42 is touched on but I think once you're in the market, it's worth noting  
43 that there are significant advantages of being an open access operator  
44 and not having to pay the extra access charges and obviously not  
45 having to pay the premium which is actually significantly higher value  
46 in terms of cost base. So, you're not competing on a like for like basis.  
47 There are also advantages in terms of fares – that you can have



1 dedicated walk-up fares only if you're an open access operator. The  
2 franchise operators are not allowed to introduce these fares – so there  
3 are clear advantages once you're in the market – of being an open  
4 access operator. I don't think those advantages should be lost.

5  
6 THE CHAIR: Ok, thank you.

7  
8 ALLIANCE: I'd just need to come back on just a couple of little bits there. It would  
9 be nice to think that the franchise operators doesn't have his own sort  
10 of on the day walk-up slightly cheaper than an inter-available fare, but  
11 you need to go back to Grand Central's arrival and the instant loss as  
12 well of an inter-available first class fare which was taken from the  
13 marketplace. But the fact of our – we paid heavy premiums, that's just  
14 a factor of bidding for something – an established business – that is  
15 your risk. The other risk that open access operators take is creating  
16 the business from scratch and all the costs that come with that. All  
17 have done it. Grand Central have done it. Alliance would like to do it.  
18 There's nothing to stop Virgin from getting in to the open access  
19 market if it really thinks it's that good because it does appear he really  
20 thinks it's that good. Or maybe it would be Stagecoach as opposed to  
21 Virgin, whichever one. Or maybe Stagecoach Virgin or maybe each,  
22 who knows.

23  
24 ALLIANCE: But the fact is there's nothing to stop anybody getting into the open  
25 access market and if it really was that easy I would not be as grey as I  
26 am today and I wouldn't have been here – I think this is 16 years now,  
27 we've been working on this. We've been successful with some, but it  
28 is tortuous. And we know what franchise business is like because the  
29 Group does it as well. But this is the exciting part because we are not  
30 creating something that the DfT want us to do, we're doing something  
31 for passengers out there – and that's really important from our point of  
32 view.

33  
34 THE CHAIR: Thank you. I wanted to broaden it out to impacts on freight. In terms  
35 of freight representatives –

36  
37 ORR: We were expecting Nigel Oatway but he sent his apologies.

38  
39 THE CHAIR: Right, ok. I think we might have to follow that up further separately.

40  
41 ALLIANCE: Just picking up a few points that were raised about ESG. Glad to hear  
42 that the Virgin 2020 timetable that Phil's quite happy for that not to be  
43 used as a basis going forward as that is the issue due to which we are  
44 currently staying away from ESG process, because of that very fact  
45 that Network Rail has included work that was developed by the DfT  
46 with Virgin and missed off all the open access operators in the  
47 application, so we wanted to actually take part in the ESG and

1 hopefully that will be taken on board by Network Rail that we will get  
2 rid of preference given to Virgin services.  
3 And then just a small point to – I hear what Stagecoach Virgin  
4 are saying about open access, it's just again rather rich that it was last  
5 year that Stagecoach South West Trains had some open access paths  
6 approved of their own.  
7

8 THE CHAIR: I must say I'm not familiar with that first point at all about exactly how  
9 the ESG is working. I don't know how relevant it is to what we're  
10 discussing now. Fiona, do you want to?  
11

12 NETWORK RAIL: I think we do want to respond to that point.  
13

14 NETWORK RAIL: Happy to. So, we did a piece of work for DfT as part of the  
15 ThamesLink Development Programme which assumes VTEC's 2020  
16 timetable as a proxy for what a long distance high speed operator  
17 timetable might look like on the East Coast in 2020. It was not part of  
18 the ESG process although it was shared at the ESG as a potentially  
19 useful piece of analysis. It's not part of the ESG process.  
20

21 THE CHAIR: Right, ok. I think let's call it on that point. There was just one final  
22 question I was going to put and I think it's a general one to VTEC. It's  
23 come out of some of the conversations about – I mean, could the  
24 argument be put forward that, given that the prospect of open access  
25 entry was well known before the franchise bids were submitted, so, in  
26 fact the impact of any entry is reflected in your bid? Is that  
27 reasonable?  
28

29 VTEC: No, I think it's not. There's two reasons for that really. The primary  
30 one was that – well, they're interwoven – there was SoSRA which  
31 gave us quite a bit of comfort. And that particularly taken against what  
32 Network Rail were saying at that stage – that there were only seven  
33 paths an hour – and if you take that as gospel and put it alongside the  
34 SoSRA, that's a pretty cast iron guarantee because obviously if there  
35 was open access, then the SoSRA would be triggered. So, that gave  
36 us a fair bit of confidence when we were contemplating how much to  
37 allow for open access in the bid – and what a reasonable allowance  
38 was. We took a lot of comfort from the combination of those two  
39 factors. Obviously, things have changed in capacity now but the  
40 SoSRA does still protect us, to an extent, depending on exactly what  
41 comes out.  
42

43 THE CHAIR: So, the prospect there'd be additional capacity beyond what you've  
44 first thought?  
45

46 VTEC: There is now, depending on seven and a half or eight paths rather  
47 than the seven paths, maybe, and we're still not convinced about that

1 from a performance point of view but that's another argument. But if  
2 there are eight paths then that could allow an extra open access  
3 operator alongside us and we would not be protected by the SoSRA.  
4 But our view at the time of the bid was that we wouldn't get open  
5 access without the SoSRA being triggered; that still left us with 20-ish  
6 percent exposed but not 100% exposed. The sort of numbers we're  
7 talking about are big numbers. The third point, at the time of the bid,  
8 was that there were two options, two applications on the table and  
9 using a conventional ORR methodology, they didn't pass the NPA test  
10 so we took a fair degree of comfort from that as well.

11  
12 THE CHAIR: Ok, thank you. Russell?

13  
14 FIRSTGROUP: I think all we'd say on that point is having re-read the ITT recently, the  
15 ITT obviously for the East Coast franchise had a specification for six  
16 paths for the franchise operator which related to the IEP business case  
17 to operate those; the SoSRA came in under certain circumstances that  
18 we've been through, but at the time that that work was going on it had  
19 already been established through the work that Network Rail was  
20 leading was that there were likely to be more paths available than the  
21 shared one for the current open access; six for an IEP, and then  
22 potentially one path had already been established at that point, which  
23 is quite clear in terms of the reports that have been produced  
24 afterwards. And if you back to look at the ITSS from the time – and I  
25 think we've made reference to this in some of our written submissions,  
26 the ITSS has been the indicative train service specification, and the  
27 discussions that are going on around that was that there were likely to  
28 be more paths available. So, I note what Andy said, but, yes, taking  
29 into account, when you look at what's happened, there are risks that  
30 other operators could run other services and I think it's a point that  
31 we've already made – or was being discussed earlier – in response to  
32 the DfT making a point about some future franchise bids. When you  
33 are doing a franchise bid, and particularly on an inter-city route, you do  
34 look at the risks that are out there where the space is – whether or not  
35 other operators could come in and you take a judgment on that.  
36 Andy's just confirmed that they took a judgment and they were  
37 satisfied to the certainty, I mean the SoSRA would cover them to a  
38 certain extent, not the full extent, but all of that doesn't take away from  
39 the fact that I think it was established, it was there to be seen, that  
40 there would likely to be more paths available.

41  
42 THE CHAIR: Thank you.

43  
44 VTEC: I think that information was post the bid process. I specifically  
45 remember a meeting with Graham Botham and Phil Verster in Leeds  
46 just after ITT, or around about the time it came out. Phil was adamant  
47 that there was no extra capacity until the CP5 funds were spent. And

1 after that, there was to be one extra path. We pushed them at that  
2 stage and didn't get very far.

3  
4 THE CHAIR: Thank you. Ian.

5  
6 ALLIANCE: Yes. It's quite interesting where we are in relation to the past, because  
7 if you go back to the Programmes Board which ran on the East Coast,  
8 from the very first one, when it was said there were seven paths on the  
9 route, we said there were eight, if you're going to spend that money,  
10 and I said that earlier on today, and I am a bit surprised, Andy, that  
11 bearing in mind the history of open access in securing and finding  
12 capacity that Network Rail consistently say is not there, that you're  
13 confident enough to believe that there wasn't further capacity beyond  
14 the seven.

15 And that also does bring me to a surprising conclusion that why  
16 have you bid for six and half? As there is already one and a quarter  
17 on the line there for open access. So, I think we're back here to:  
18 someone's taken, as you do, a risk, a price risk, they wanted to share  
19 that risk with the taxpayer, as we've just heard, and because there  
20 happens to be more capacity now, they're just trying to fill up the  
21 capacity with services of their own to prevent the competition. And  
22 again, that's historical behaviour from National Express before them,  
23 from GNER before that. It's just the way the monopolistic operator  
24 always operates on the route.

25  
26 THE CHAIR: Thank you. Russell?

27  
28 FIRSTGROUP: Just one final point, I think this is probably bound to the point that Rob  
29 made at the very beginning about the general nature of the paths and  
30 the amount number of paths per hour that we're talking about because  
31 if we're talking about seven and a half, then that implies there is eight  
32 in one hour and seven in the next, so, if there's a standard pattern  
33 timetable, there will be eight every hour. Anyhow, I don't want to re-  
34 open the debate but clearly seven and a half means eight.

35  
36 THE CHAIR: Right.

37  
38 VTEC: Eight paths with compromises.

39  
40 FIRSTGROUP: Absolutely with compromises, not saying there wouldn't be any  
41 compromises, Phil, but I'm saying that seven and a half means eight in  
42 one hour.

43  
44 THE CHAIR: On that, are there any more points on that area? Because I'm back to,  
45 I'm going to close the section now on impacts and I'm going to move  
46 on to the final session today around appraisal issues. So, is everyone  
47 content? Right. I'm going to hand over to Chris.

1  
2 ORR:

3 So, this session is on further issues around economic appraisal. I  
4 think there are two particular issues that we want to spend a little bit of  
5 time on. Some of this is just around clarity of treatment.

6 These two issues are the treatment of infrastructure cost,  
7 particularly the cost of tilt infrastructure, and then rolling stock costs,  
8 which is in particular the treatment of the IEP fleet. If I take those in  
9 turn.

10 Infrastructure first. I think there have been a lot of things said  
11 about this but it is probably worth being absolutely clear what's  
12 happening here. We asked CH2M Hill to ignore the cost of the tilt  
13 operation in their report. This reflected the high degree of uncertainty  
14 about the right number to include for this cost. We agreed with parties  
15 who have emphasised that the cost of infrastructure needs to be  
16 included in any appraisal and I think it was clear from the start that that  
17 was what we were trying to do. So, that is what we're doing.

18 In terms of what is the right number to interpret, it's not just the  
19 CH2M numbers. I think CH2M's made that very clear in their reports.  
20 So, that is a basis for this discussion.

21 So, in that sense, I don't think, although I'm happy for that to be  
22 challenged, that there is actually a real disagreement about the  
23 appropriate treatment of the costs of infrastructure. If it relates to the  
24 benefits that we're talking about it is necessary for the option, it should  
25 be in the appraisal.

26 I think what there is then less agreement on, and less  
27 information, is the right number to use for the costs of tilt. Now, on that  
28 latter point, I think parties have set out what they know about what that  
29 cost might be, so, again, I'm not sure that there's much to be added  
30 from spending a lot of time debating that number. I think when we  
31 open this up further for discussion it's worth being really clear that I  
32 don't think there's a disagreement on the appropriate approach. It will  
33 be an interesting debate, I think, as to what's the right number to use.

34 THE CHAIR:

35 Can I open it up?

36 ALLIANCE:

37 Can I just add quickly to that? The other infrastructure investment that  
38 is proposed from Alliance, of course, is East Leeds Parkway, and  
39 that's in our business plan and that's very clear. And unlike the tilt  
40 option on the East Coast Main Line, for which we've been waiting of  
41 course for the position on power supply, which was always our position  
42 and we've made that quite clear. Now, that is clear that you do have a  
43 figure on them, and we can back that up with the work that Network  
44 Rail did in relation to the new station that's proposed on that route.  
45 And that one in particular does, we believe, create capacity, not only  
46 for our services heading to West Yorkshire, but, as our colleagues at  
47 VTEC have already said they would use that station, of course,  
because that would also be their route into West Yorkshire.

1  
2 THE CHAIR: Ok, thank you. Chris?  
3  
4 ALLIANCE: Can I just clarify that point Ian made on power supply? Yes, it's right,  
5 we did make it clear the reason we did not proceed with quite an  
6 expensive study with Network Rail to determine the infrastructure  
7 costs of enabling tilt was because we believed that power supply was  
8 potentially a show-stopping issue. And I think we were vindicated in  
9 that by the latest report although Network Rail has now identified  
10 solutions to the power supply problems. They have determined that  
11 there is no capacity north of York for additional electric trains until  
12 significant investment is made in upgrading the feeder stations. And  
13 that, as determined earlier on, is dependent on CP6 funding and I think  
14 we all know that in the current environment, especially as we've heard  
15 from DfT how difficult funds are, how tight funds are, there must be  
16 some question about even whether that can be achieved in CP6  
17 because power, feeder station upgrades are very expensive in terms  
18 of fitting them out to achieve that for each one. There are five, I think,  
19 that need upgrading. So, it's not an insignificant expenditure that's  
20 needed on power supply before additional electric trains can run to  
21 York. So, I just wanted to clarify that we've been waiting for that. It  
22 now seems that the earliest any further electric trains could run would  
23 be May 2021. And my own view is it's probably later than that.  
24  
25 THE CHAIR: Thank you. Graham?  
26  
27 NETWORK RAIL: I guess if I'm being drawn into it, I maybe should clarify. We've been  
28 quite clear. We have not yet completed GRIP 3 on the power supply  
29 upgrade for the East Coast Main Line. That is shown for February  
30 next year and it's at that point we would know how much that would  
31 cost and what the precise proposed solution would be.  
32  
33 ALLIANCE: Sorry, to come back on that Graham, but do you accept that however,  
34 whatever you do have to do that each feeder station upgrade would  
35 cost in the order of 20 million pounds?  
36  
37 NETWORK RAIL: Chris, I don't know, because we need to do the piece of work first.  
38  
39 ALLIANCE: Surely, Network Rail has some figures? How does it work? It has  
40 upgraded feeder stations in the recent past, they must have some idea  
41 of what it costs to upgrade.  
42  
43 THE CHAIR: I think Graham's refusing to speculate so I'll move on.  
44  
45 ALLIANCE: Just a quick one, John, I might be able to throw some light and I think  
46 David will be able to back me up with the stakeholder meeting that we  
47 had earlier this week, although it was a generic, ordinary figure, there

1 was a suggestion that in to CP6 it might be a round about £100 million,  
2 I think. Is that right, David? I think that's what was said at the time.  
3

4 THE CHAIR: This relates to the power supply?  
5

6 ALLIANCE: And that was a Network Rail meeting that we attended in relation to  
7 stakeholders for the East Coast. It's not as specific, obviously, and  
8 they admitted it's not at GRIP 3, but they believe it will be in the order  
9 of around about £100 million.  
10

11 THE CHAIR: Ok, thank you.  
12

13 VTEC: Yes. I'm just surprised that an application to take in the order of over  
14 £100 million a year extraction from the incumbent operator over a 10-  
15 year period, wouldn't warrant an investment of £100,000 or £200,000  
16 into a study to understand the indicative costs for tilt. And to say, well,  
17 we're not going to do that until we understand what the power supply  
18 situation is, is extraordinary. The application has been on the table  
19 since December 2013. And there has been quite a lot of time to be  
20 able to do a tilt study and to understand what those costs might be.  
21

22 THE CHAIR: Would you like to come back on that?  
23

24 ALLIANCE: Yes, I know, there are numerous reports sat around covered in dust  
25 that Network Rail have done historically for all sorts of things on the  
26 route. The fact is, at the moment as well, Network Rail are not  
27 particularly good, and this is not a pop at Network Rail, at actually  
28 putting a price to any particular work, especially in relation to  
29 something like tilt on the route. There is not really any in-house  
30 expertise. And the fact is, unless we can sort out the power supply,  
31 then it would have been a quite expensive piece of aborted work. And  
32 we've made it clear right from the very beginning, with Network Rail,  
33 and here, in previous meetings, that until that was clear, it was not  
34 worth us investing that money and that seems to have been a wise  
35 choice bearing in mind where we are today.  
36

37 THE CHAIR: Thank you.  
38

39 VTEC: Can I just come back on East Leeds Parkway? It's a bit of a broad  
40 point and it comes back as well to the economic assessment in terms  
41 of should the benefit of the station and the benefit to Alliance, as  
42 proposed, be reflected at all? So, just to bring to your attention the  
43 West Yorkshire Combined Authority had a Transport Committee  
44 meeting last Friday. There's a paper which is publicly available  
45 giving an update on East Leeds Parkway Station which says that there  
46 were a significant number of issues to resolve in taking East Leeds  
47 Parkway forward and it concludes that it proposes to review options

1 now for the station including the location. This is a station which is not  
2 even at GRIP zero in the Network Rail process. There must be  
3 significant doubt as to whether it will open to the timescale that Ian is  
4 expecting it to. And indeed whether it will actually open before CP7.  
5 And we can talk about funding contributions but I just question whether  
6 the benefits of this station should be reflected in the evaluation at all.  
7

8 ALLIANCE: I'm not familiar with the particulars of that meeting or whether that  
9 meeting – that was new information that was tabled at that meeting or  
10 not.

11

12 ORR: It's new information to us as well. I wasn't aware of that.

13

14 VTEC: I'm very happy to provide.

15

16 THE CHAIR: Ok, right. Thank you.

17

18 DFT: Just one very quick question? It's just a question almost for you John  
19 and to Chris. So, we accept that the infrastructure costs should be  
20 taken into account, but there isn't a – or at least I'm not hearing, a  
21 number. I'm trying to understand how exactly that's going to feed  
22 through to your process.

23

24 ORR: Yes. There are a series of numbers around that are estimates from  
25 parties. I think in terms of the decision making process, one of the key  
26 things we need to establish is the extent to which that number matters.  
27 So there are a number of scenarios where when we look at the size,  
28 and we go into benefits and costs, this isn't a significant swing factor.  
29 If it is, then we'd have to decide what sort of recommendation we could  
30 put to our Board and equally the Board would decide on whether they  
31 had enough information to take a decision. And it's difficult to  
32 speculate too much on that. But I'm thinking the important thing is that  
33 one of the key concepts is how much does it matter to the decision  
34 because it may not.

35

36 THE CHAIR: Okay.

37

38 ALLIANCE: John, just one quick one, just to come back on East Leeds Parkway. It  
39 is actually quite irrelevant what West Yorkshire Combined Authority  
40 might believe because as we made it clear in our business plan, we  
41 will fund that station. David's quite right. If we go through the GRIP  
42 process, we'll probably be back here in five years still talking about this  
43 station. The fact is Arriva has expertise in building railway stations  
44 outside the Network Rail programme, Warwick Parkway is a classic  
45 example on the Marylebone route. So, we mustn't get hung up on the  
46 fact that Network Rail's processes take an extremely long time and  
47 what Network Rail are seeking at the moment – and indeed what the



1 industry's seeking at the moment – is real, third party investment – and  
2 that's exactly where we come along. This is not new. It's not  
3 something I've just popped in my plan. You've had it in our plan for  
4 over two years. And it's something we really want to develop. Where  
5 it's located, that's the discussions we've got with Network Rail at the  
6 minute. But we do believe it unlocks some capacity on the route not  
7 only for the benefit of people that currently use the route but also for  
8 ourselves and ironically for Virgin.  
9

10 THE CHAIR:

Thank you. I think that probably wraps that point up? Thank you very  
11 much.  
12

13 ORR:

Thanks for that. And I think we now move on to the second of these,  
14 this is the rolling stock costs. Again, it's worth being clear, we asked -  
15 because we knew there's some uncertainty about the 'right' number to  
16 put in - CH2M to adopt a particular assumption in their report and it is  
17 clearly set out what they've done. We need to separately decide what  
18 is the right approach for the treatment of that rolling stock cost. This is  
19 something that we flagged in our technical note that we published  
20 alongside the report.

21 I think there are two questions here. I think the first of them can  
22 be summarised as being: How much of the IEP costs are sunk in  
23 economic terms? That is in essence an economic question, in terms  
24 of just the facts of the case. How much are sunk?

25 And then the second question, which is quite different in nature,  
26 is a question around: how much weight should we place on the fact  
27 these costs are sunk when we assess them against the statutory  
28 duties?

29 It would be worth saying a few words on both those questions  
30 separately because they're quite different in nature.

31 Taking the first: To what extent are the IEP costs economically  
32 sunk, if I can use that kind of phrase?

33 As set out in our technical notes, we're interested in exploring  
34 the extent to which those IEP costs are actually sunk. We're trying to  
35 identify here both the costs that have been incurred and the extent to  
36 which they cannot be retrieved. It's both of those things: it is an 'AND'.  
37 The costs have to be incurred AND they cannot be retrieved.

38 So, the second point here, I think, is where the debate should  
39 focus. I don't think anyone is debating the fact that they've been  
40 incurred in terms of 'a contract had been signed'. So, the ongoing  
41 issue is, whether they can be retrieved? What that really means, in  
42 terms of turning that WebTAG language into more common parlance,  
43 is: Can the Department through its action reduce that cost? They  
44 could reduce that cost in a number of different ways by redeploying the  
45 rolling stock or renegotiating that contract. DfT have made a number  
46 of points, which I think you've all seen, and I think neither of those  
47 strategies are without costs but the issue is obviously how much cost

1 might be saved through following either of those strategies to redeploy  
2 the rolling stock or to renegotiate the contracts.

3 It might be worth pausing there, really, in terms of that key issue  
4 of whether they are economically sunk – and those two issues of views  
5 about redeployment and renegotiation of the contracts.  
6

7 THE CHAIR: Okay. Does anybody have any comments to make?  
8

9 ALLIANCE: Well, certainly on the redeployment case on the East Coast Main Line  
10 because I know they have a view they can't go anywhere else, which  
11 is rather strange for a train that's meant to be compliant in the UK, we  
12 require eight for our West Yorkshire / Cleethorpes services.  
13

14 [LAUGHTER]  
15

16 ALLIANCE: There is a surplus because we haven't ordered any because we  
17 haven't sunk any costs yet and we're quite happy to pick up the  
18 surplus, so that's eight sorted. And of course our colleagues here,  
19 they want five, is it? I'm not quite sure. So there's quite a large  
20 amount of the fleet that could be redeployed.  
21

22 THE CHAIR: Ok, thank you. I'm not sure DfT have noted that offer. Russell?  
23

24 FIRSTGROUP: I wasn't going to make the same offer, I was thinking a slightly different  
25 configuration. In terms of – I suppose what we would say about it is  
26 that the original business case for those trains on the East Coast was  
27 for the six paths that were in the specification for the ITT that VTEC bid  
28 against and were successful against. So, if they were to get those six  
29 paths and that still leaves, another path - I don't think you can retrieve  
30 those costs in the sense of that.

31 In terms of deployment, I would just expand a little bit on Ian's  
32 first point which is those types of trains currently could appear in  
33 several places across the UK. And there are clearly opportunities to  
34 use them at a number of locations. There are other franchises that are  
35 coming up soon and I'm sure that those trains could be used on a  
36 number of different routes. If we were in a situation, which I don't think  
37 we would be – of the East Coast franchise having less than six paths.  
38

39 ORR: That could be quite an important point there really. So, if people are  
40 agreeing with this as a characterisation of what we're considering  
41 here, the implication of what you said about the six paths is that this  
42 debate only matters in the scenarios where VTEC doesn't have the  
43 sixth path. And it would be helpful if people would agree that is an  
44 appropriate way of thinking about it. And if, once you have the agreed  
45 that, the debate about sunk IEP costs is largely moot for the other  
46 options.  
47

1 THE CHAIR: Can we just check that?  
2  
3 VTEC: I think it's difficult to say. If we had the full six paths, with all the  
4 extensions, then in that case we could use the full IEP fleet. We don't  
5 need the 225's for the VTEC Core, as CH2M call it. That would not use  
6 all the IEP fleet. VTEC Core plus Bradford, Harrogate, Lincoln, i.e. all  
7 the extensions, would use the full IEP fleet.  
8  
9 THE CHAIR: Ok, thank you.  
10  
11 ORR: I was just wondering, can the Department confirm? That's right, is it?  
12 DFT: As far as we're aware, yes, but I think as VTEC is the expert on how  
13 its trains should be diagrammed –  
14  
15 THE CHAIR: Ok, fair enough. Anything else on that point? Okay. That's helpful.  
16  
17 ORR: I think actually that's quite an important rider for what I'm about to  
18 move on to, really. I think that what I'm about to say now really only  
19 follows for the case where the IEP order is not fully deployed. But I  
20 guess there are some points that have been made around how we  
21 should look at those costs.  
22 First the issue of are they economically sunk? We've covered  
23 that, I think, and made some progress.  
24 So, then there is the issue of how do we assess that issue  
25 against our statutory duties? Now, I think there are broadly two sides  
26 to this: two ways you could point to our statutory duties. I think one is  
27 that if we treated the economically sunk costs in that way – so, we  
28 actually ignore them from the appraisal – that could be seen as  
29 distorting the decision making process because it gives a first mover  
30 advantage – it's not quite the right way of putting that – but, a sort of  
31 first mover advantage to anyone who has the resources to sink costs  
32 in rolling stock contracts. That's one side.  
33 The counter view, I think, is that obviously if we took that  
34 decision, it may strand some costs and impose some real costs on  
35 parties to those contracts. Those sorts of considerations would relate  
36 to other aspects of our statutory duties: such as efficiency and  
37 economy; to plan your future business; value for money; and, of  
38 course, the impact on the Secretary of State funds.  
39 So, it appears that the treatment of this, you could argue, might  
40 differ depending on the weight you place on those various statutory  
41 duties. Now, I know this is an area where's there isn't a particularly  
42 scientific answer but that at least explains some of our thinking in  
43 relation to how we relate this issue to our statutory duties, which again  
44 goes to the point that it's only relevant I think in certain circumstances  
45 for this case.  
46  
47 THE CHAIR: Yes, let's pause there. Do people recognise that as a position? Ian?

1  
2 ALLIANCE: Yes, this is a difficult one of course because you're talking about two  
3 private operators investing money and therefore I'd have to question  
4 as to why it drops into the appraisal in the same way because most of  
5 the appraisal is based upon public investment, as opposed to private  
6 investment. I can see the argument for some of the costs because  
7 they're here and the taxpayer's behind it but like our colleagues at First  
8 we're not expecting that fleet can't be used at some particular time.  
9 But in relation to the cost, if you're going to regard it as sunk, then  
10 maybe you should regard the others as sunk, even though they're not,  
11 on the basis that the investment is completely separate; it's really of no  
12 relevance to anybody other than the investor himself; otherwise, as  
13 you've rightly pointed out, and we've got an issue with Grand Central  
14 soon, because GC has more rolling stock than they can use, or will  
15 have soon. It then puts somebody at a significant advantage. You  
16 know, do we then go and buy rolling stock and come along and, say,  
17 well, we've got trains here, so, you know. I know they're going to  
18 replace trains on another line for example but actually we've got some  
19 so, you know, our plan is going to be significantly better than anybody  
20 else's plan. So, it is a real issue for you I think in respect of that. And  
21 I'm not quite sure what ultimate value this piece of work in the real  
22 evaluation of what the benefits are, is actually going to make in the  
23 long term.

24  
25 THE CHAIR: Ok, thank you. Chris and then I'll bring in DfT.

26  
27 FIRSTGROUP: The first of your questions was undoubtedly an economic question.  
28 The second one is essentially, as we understand it, a legal question  
29 under Section 4. The particular criteria that you identify are probably  
30 the right ones but just taking each one of them – the criteria - in turn.

31 The impact on the Secretary of State's funds. There is a  
32 synergy here, between the six paths which applies to the economic  
33 question and whether it ever becomes an issue under the legal  
34 question because if the fleet is fully utilised at six, the impact then  
35 drops away. So, it becomes academic and actually drops out of the  
36 equation as a matter of practicality.

37 The planning with certainty isn't an absolute. The point  
38 probably tracks back to Andy's point that what 'planning with certainty'  
39 doesn't mean is that if you invest in the hope of getting paths later,  
40 then you're entitled to bank that and have that taken into account as  
41 an additional decision criterion in the evaluation of Section 4 duties.  
42 That would not be a proper application of Section 4 duties.

43 On efficiency and economy, that is really a head which is  
44 directed to the way in which people conduct their operational business  
45 rather than a forward planning issue. And that is, in our submission,  
46 about the way in which rolling stock procurements are done rather  
47 than about an issue of comparative advantage of timing related to an

1 access application. So, for reasons both of principle and practicality  
2 under each of these three heads, we're not seeing that any particular  
3 clash arises, particularly as it probably doesn't arise anyway because  
4 the costs aren't sunk because of the six paths.

5  
6 THE CHAIR: Ok, thank you.

7  
8 DFT: I just wanted to say in relation to Chris Hemsley's laying out of the  
9 issue earlier, I actually think Chris you laid out the issue exactly right.  
10 So you've got this situation of "first mover advantage" which puts you  
11 in a difficult situation, in terms of whether or not you should fully treat  
12 the costs as sunk in the appraisal or if that distorts competition  
13 between the applicants. And I appreciate that that's the trade-off that  
14 you have to look at. The point I would make, is that the only way  
15 which you could sensibly look at this trade-off is by looking at the size  
16 of the relevant costs which would normally be treated as sunk. So, to  
17 give an extreme hypothetical: If that component of the sunk costs  
18 within the application was equal to the GDP of the UK, my working  
19 assumption is that the ORR would at that point say, fine, this  
20 supersedes any strategic argument which we're laying out on the other  
21 end, (which is in relation to the distortion of the competition). So again,  
22 I think the only way to sensibly approach that framework which you've  
23 articulated very well would be to start by treating the numbers as  
24 standard WebTAG / Green Book appraisal guidance suggests that you  
25 should do.

26 But my second point is this: to be able to do that, you need to  
27 consider the extent to which the costs would reduce if the IEPs were  
28 used for less mileage than is assumed within the contract with Agility.  
29 Now, we are happy to provide that information to you but unfortunately  
30 for some reason the ORR has refused to give the DfT the requisite  
31 assurances that the commercially confidential data that we would be  
32 passing on from Agility would not be shared with other applicants or  
33 published. And unfortunately therefore, it's impossible for you to  
34 actually look at the numbers properly to answer the question of  
35 whether or not the extent to which the costs are sunk should  
36 supersede the strategic arguments about the distortion of competition.

37  
38 THE CHAIR: I think, sorry, to be fair, we did explain why we were unable to offer  
39 those assurances. We have exchanged letters. It's not as if it was  
40 some gratuitous refusal. We did explain quite clearly why we couldn't  
41 do that.

42  
43 DFT: Sorry, can we?

44  
45 DFT: The only other thing that I was going to add to that was I know there's  
46 been correspondence on that. I've seen it in my inbox but I note that –  
47 and maybe I've misunderstood something – during the discussion

1 earlier today FirstGroup were talking about some of the data that  
2 they've provided to CH2M Hill in relation to their fares strategy. And  
3 as I understand it there is a non-disclosure agreement there. It's not  
4 clear to me why similar assurances couldn't have been provided to the  
5 Department in relation to the IEP mileage adjustment rates within the  
6 IEP contract.  
7

8 THE CHAIR: To the best of my knowledge, we've not signed any non-disclosure  
9 agreements with anybody.

10  
11 DFT: I may have misunderstood an arrangement that was outlined earlier.

12  
13 THE CHAIR: I thought that was a reference to something to do with, a commercial  
14 arrangement with CH2M Hill. It's not a reference to us.

15  
16 DFT: Ok, then equally, we could presumably enter a non-disclosure  
17 agreement with CH2M Hill so that they could provide you with an  
18 appraisal that accurately reflected the nature of the IEP contract?  
19

20 THE CHAIR: I'm not sure how that would work in practice but I'm happy to think  
21 about it. Ok, thank you.

22  
23 DFT: We have other points about the appraisal that we meant to make that  
24 don't relate to the two points that you raised about IEP, so I don't know  
25 when is a good point to make here –  
26

27 THE CHAIR: Yes. Let's just see if there's any more on this one and then I'll bring  
28 you back in on that. Is there anything more on those? Simon?  
29

30 ALLIANCE: I can see why Chris is wrestling with this. If you don't take into  
31 account the supposedly sunk costs of IEP, don't include those sunk  
32 costs in the appraisal, it sets a rather awkward precedent, in that it  
33 makes it very easy in future, where you have a situation like this,  
34 where there is a franchise operator who is, or an operator that's  
35 bidding for a franchise, or a franchise competition is under way – and,  
36 on the other hand there are open access applications that are not yet  
37 determined – that are on the table – that the DfT could do what they've  
38 done. Admittedly, not for this specific reason. In the case of IEP and  
39 ordered the trains, and then told the franchise operator that those are  
40 the trains that they will use – and then say: well, that's a sunk cost and  
41 therefore those costs should not be included in the appraisal alongside  
42 the costs of the open access operator. Because clearly no open  
43 access operator will order trains until they've got paths where they can  
44 use them. Arguably, the DfT shouldn't be ordering trains before they  
45 know whether there are paths to use them but they're in a rather more  
46 powerful financial position. They also have the potential opportunity to  
47 use them elsewhere on the network. So, I think for a fair comparison

1 it's clear that the costs of rolling stock for all the applicants should be  
2 taken into account. Now, I do appreciate that you also need to take  
3 account of the possible impacts on the Secretary of State and so on,  
4 so you may then also need to do an assessment which says: well,  
5 what will happen if the franchise operator is unable to use those trains  
6 fully as a consequence of the access decisions that you make. But, I  
7 do think this is where I disagree with Enrico, that the core appraisal  
8 does need to take the full rolling stock costs of all the applicants into  
9 account.

10  
11 THE CHAIR: Ok, thank you.

12  
13 VTEC: Could I just? I mean this a bit out there – but the reference that you  
14 are somewhat at a disadvantage because you don't have the  
15 resources to go out and buy some trains was wrong. You're owned by  
16 German State Railways. You could go out and buy trains.

17  
18 ALLIANCE: I could say something on this point as well but I'm going to let Simon  
19 get in first –

20  
21 ALLIANCE: Yes, clearly Deutsche Bahn could afford to buy some new trains  
22 speculatively. Probably, Stagecoach could afford to buy some new  
23 trains speculatively. But neither party would do so. The DfT and  
24 indeed no other franchise operator has bought new rolling stock when  
25 that's been part of their franchise competition, until they know that  
26 they've won. I mean First are in the course of ordering new rolling  
27 stock for TPE, now they've won. Arriva have ordered new rolling stock  
28 for Northern now that they know that they've won. They would have  
29 been crazy to do it beforehand. The only people who can order rolling  
30 stock in advance for a franchise are the DfT because they know that  
31 they are going to buy those franchise services.

32  
33 THE CHAIR: Ok, thank you. Well, Ian, did you want to come in?

34  
35 ALLIANCE: No, I'd better not.

36  
37 [LAUGHTER]

38  
39 THE CHAIR: Okay. Thank you. Okay. Let me just check with Chris. Chris, I think  
40 that now wraps up all our points.

41  
42 ORR: Yes.

43  
44 THE CHAIR: I'm now going to pause briefly to see if there's any material – I'll come  
45 to you in a minute, Simon – whether there's any material points that  
46 people think haven't been raised that they'd just like very briefly to put  
47 on the table in this area? If not, I'm going to go straight to Simon.

1  
2 DFT:

3 Thank you. I think when we've been looking at the appraisal results,  
4 you also have to take into account that the appraisal is the result of all  
5 the elements, including the capacity analysis, and the demand  
6 modelling that we were discussing earlier. And what was clear from  
7 the discussion earlier was that some of the fares crowding and  
8 timetable assumptions, particularly for the First Group application, in  
9 the current CH2M analysis, are simply not credible. That the  
10 FirstGroup fares in practice would be much, much higher than has  
11 been assumed in the CH2M analysis because as a rational  
12 commercial operator, they would increase their fares so that demand  
13 and capacity were reasonably in balance. And then this has a  
14 significant impact on the economic appraisal. So, the CH2M analysis  
15 is presents NPVs for the open access and franchised operator options.  
16 In our analysis, in the NPVs for the open access options, a significant  
17 part of the positive NPV, is actually the private sector profit made by  
18 the open access operator. In our own analysis, by the mid-2020s,  
19 reflecting the fact that it's fares will be much higher, we think, than  
20 assumed in its business plan – and really much closer to those  
21 charged by the franchise operator, we have estimated FirstGroup  
22 having an operating margin of in the region of 60%, which is, whilst it  
23 sounds ridiculously high, is actually not dissimilar to what at that point  
24 a franchised operator would be making – if it didn't have to pay fixed  
25 track access charges or premium or capacity charges and therefore  
26 was facing the same basic economics as the open access operator  
27 was, at that point. And I think that demonstrates that the NPVs as  
28 reported by CH2M, are not a sensible way of reporting the results of  
29 an appraisal in these circumstances. WebTAG guidance is clear that  
30 in the case that public expenditure is limited and options have different  
31 impacts on public expenditure, the relevant metric to study, is the  
32 benefit to cost ratio. And NPV is only relevant where options do not  
33 impact the broad transport budget. If you do compare NPVs for  
34 options that have very different impacts on the transport budget, you  
35 really ought to be taking into account, in that NPV, the dis-benefit of  
36 whatever other bit of expenditure has to be stopped in the options that  
37 have big negative impacts on the transport budget.

38 So, I would encourage the ORR firstly to re-appraise all of the  
39 options taking into account the feedback today, but, particularly, the  
40 fares and timetable assumptions that have been made in respect of  
41 the FirstGroup application, as those appear to be most significantly  
42 questionable. But also, once it's done that, to study a benefit to cost  
43 ratio – the benefits that would be achieved for the amount of public  
44 money that was sunk into each of these options rather than simply  
45 looking at the NPVs which we just think is not appropriate. Thank you.

46 THE CHAIR: Okay. Thank you. Lucy?  
47



1 | SDG: Just a couple of points to reiterate there what Simon was mentioning.  
2 | Our own analysis found that the private sector benefits were in excess  
3 | of the sum of the user and non-user benefits for the open access  
4 | options. For example, for the First Edinburgh option we found  
5 | combined user and non-user benefits were £250 million but private  
6 | sector benefits were £290 million. With the Alliance West Yorkshire /  
7 | Cleethorpes option, we estimate a combined user and non-user  
8 | benefits of £200 million and private sector benefits of £320 million.  
9 | Now, those private sector benefits are effectively ultimately  
10 | being paid for by the government.  
11 | And I just wanted to make one more point. Simon raised that  
12 | the premium would otherwise be higher – if it wasn't the case.  
13 | I just wanted to raise one other point, as Simon was saying,  
14 | we've got doubts about the fare estimates and the crowding estimates  
15 | as they relate to revenue. Those have an impact on the economic  
16 | results because you're getting economic and crowding benefits. But  
17 | just today I was reflecting on what FirstGroup has said about their  
18 | proposed fares structure and CH2M's modelling approach and it  
19 | occurred to me that FirstGroup has said that most of their tickets will  
20 | be Advance Purchase tickets. Then I remembered that CH2M HILL  
21 | actually allocate AP demand according to train capacity and just re-  
22 | reading your report, you allocate AP demand just according to spare  
23 | spaces on trains and then you cap the demand based on the  
24 | availability of capacity, it says, in your report – both capacity and fares.  
25 | So, that might be partly why you're not getting those high load factors  
26 | which lead you to think that FirstGroup wouldn't actually offer those  
27 | fare discounts. So, that's just something to have a look at and just  
28 | consider the implications of that assumption.  
29 |  
30 | THE CHAIR: Okay, why don't you come in first, Chris?  
31 |  
32 | ORR: I mean in terms of the FirstGroup option, we've already said that we're  
33 | going to do some work there. So, we've said that already. I think it's  
34 | worth noting that we've never said that we are simply looking at the  
35 | NPV. That is not our approach. We've made very clear that we  
36 | consider all the effects, including the magnitudes of costs that we  
37 | impose on the Secretary of State. I think I can understand: I've read  
38 | WebTAG, I've read the Green Book. I understand what you're saying.  
39 | I don't think the way that we've presented the results, but more  
40 | importantly, the way that we're going to actually use those results in  
41 | our decision making is going to depend on the precise ratio that we  
42 | use. The main point is we are going to look at all the effects against  
43 | our statutory duties.  
44 |  
45 | THE CHAIR: Chris?  
46 |  
47 | CH2M HILL: So, we have run our crowding model, as I've said before, and for one

1 of the three FirstGroup options which were tested (i.e. the option  
2 where the overtaking manoeuvre in the southbound direction is  
3 removed), the model indicated to us that the load factors would not be  
4 sustained on a long term basis. So, as we stated in our larger report,  
5 back in October, we increased the fares to the point that we felt that  
6 load factors were sustainable and the discount, or the reduction in the  
7 discount offered by FirstGroup is reported. Thank you.  
8

9 THE CHAIR: Thank you.

10  
11 ALLIANCE: I think this is a bit like the discussion we just had about sunk costs.  
12 There are different ways of looking at the economic case. One way of  
13 looking at it is to look at the overall benefits to society from each of  
14 these applications and the resources that need to be devoted to unlock  
15 those benefits. So, a fairly classic cost benefit analysis which will give  
16 you, granted with the inclusion of infrastructure costs where  
17 appropriate, will give you an NPV, and it will give you one way of  
18 measuring BCR. And I think that is probably very important from the  
19 point of view of understanding the benefits in terms of economic  
20 efficiency, benefits to users, promoting competition, promoting use of  
21 the railway for maximising use of the railway – those types of duties.  
22 Then there is the question of the cost to government which is clearly  
23 another of your duties. And the UK Government has a very particular  
24 view of the way to undertake economic appraisal and assessing cost  
25 to government in that appraisal which is not consistent with what is  
26 done in many other countries. It's not consistent either with the way  
27 the European Union does it. There are reasons for this. You can  
28 argue that different methods of doing economic appraisal have  
29 strengths and weaknesses but I think for a core assessment of the  
30 value to society of these applications the way that it is being done by  
31 ORR is generally correct. It may be a little conservative in terms of  
32 things like wider economic benefit, but broadly I think it's the right  
33 approach.

34 I recognise that you also need to consider the cost to  
35 government, albeit, we think the cost to government, if any, will be  
36 orders of magnitude less than the DfT do because they have in our  
37 view erroneous antipathy to open access.  
38

39 THE CHAIR: Ok, thank you. Russell?

40  
41 FIRSTGROUP: I suppose all I was going to say is that our application – there's a lot of  
42 information that's contained within our application that we submitted to  
43 the ORR. And, yes, it's our business plan and yes, it is confidential.  
44 And it is confidential for the reasons that if you read it, you would  
45 know, but it, by its very nature, I can't describe, I can't give you details  
46 about what's in it because that's our commercial in confidence IP. We  
47 think that this is a new and innovative way of providing capacity on the

1 network. We stand by everything that we have said in that application  
2 to the ORR and I'll stand by what we've said again on our fares and  
3 the way in which we're going to approach our operation.  
4

5 THE CHAIR: Ok, thank you. Ian?  
6

7 ALLIANCE: Yes. Just to say, for summing up for ourselves, our applications are  
8 the longest standing applications here. I hear what Lucy says about  
9 the value of all our services. That might be one of the reasons why  
10 VTEC have copied a number of them in the same way that National  
11 Express did some time ago. And again we must keep reminding the  
12 DfT that they have opportunities through levies etc. if they really feel  
13 that there's an issue here about not paying the same arrangements for  
14 services.  
15

16 Our applications are two-fold. One is a very early application  
17 for a record breaking, completely ground-breaking service between  
18 London and Scotland. In the same way that it was proposed 10 years  
19 ago and at that time rejected by the DfT for the franchise at that  
20 particular time.

21 Our service to West Yorkshire and Cleethorpes is a traditional  
22 open access service. Not one that should be difficult to measure. I'm  
23 a bit surprised that Andy believes that all these fail the NPA tests  
24 because clearly they don't fail the NPA test; they don't fail it through  
25 your normal measurement tools and they certainly don't fail it through  
26 those or through our own.

27 And the services are designed to grow the market, niche  
28 markets into different areas – and exactly as happened in 2009 with  
29 National Express we know when we make these applications so early  
30 we run the risk of them being cloned and that's happened. Our  
31 colleagues at FirstGroup, it was a later application – I don't need to go  
32 through that. I can understand why the DfT get very upset about that  
33 one because that came along after the event but certainly the  
34 applications that were looked at in relation to ours were well known.  
35 One of them very traditional, apart from the fact there's station  
36 investment which will be important in relation to releasing capacity.  
37 So, I think we're looking here at ground-breaking, record-breaking type  
38 of service with – Andy makes a fair point that we've not been able to  
39 deal with as such, an undetermined amount of investment required in  
40 the infrastructure. And another one, more traditional, but opening up a  
41 market in the way that the previous franchise suggested a station on  
42 that route would open up the market. So, we're not revisiting, or we're  
43 re-visiting things that have been done before. We have a good track  
44 record of innovation. We have a good track record of growing the  
45 market. We have a good track record of understanding the niche  
46 markets that we develop and as a result we like to think that of the  
47 applications that you have in front of you, our applications are the  
easiest ones to see for their significant benefit.

1  
2 THE CHAIR: Ok, thank you, Ian. I am going to start drawing things to a close and if  
3 there's any final, very material, and I use that phrase very carefully,  
4 very material points anybody wants to make? Russell?  
5  
6 FIRSTGROUP: It's only, there's been a couple of, well, there's been a number of  
7 pieces of new information, and new figures disclosed in the meeting  
8 today. And I'm not sure of the status of them – whether they can be  
9 fully shared. I know some of them have been referred to and said  
10 'more detail will be provided'.  
11  
12 THE CHAIR: Yes. We'll pick up those from the transcript and we have to make sure  
13 we clarify who we think has agreed to send round what and if you  
14 disagree with us, then let us know.  
15  
16 FIRSTGROUP: Thank you.  
17  
18 THE CHAIR: So, we will pick up on that. Yes. Chris?  
19  
20 ALLIANCE: Chris Hanks. One thing that since lunch time, I should have picked up  
21 this morning really, I wasn't clear, I'm not sure, whether it was made  
22 clear this morning but I didn't pick up whether the AT300s FirstGroup  
23 are proposing for their service are bi-mode or fully electric trains. I  
24 think that is material, given the discussion we had about power supply.  
25  
26 FIRSTGROUP: I think as we said in our application, that they're electric.  
27  
28 THE CHAIR: Ok, thank you. Right, ok, thanks very much. I'm just going to bring  
29 things to a close. I just want to say three things about next steps.  
30 First of all, we will circulate the transcript for checking and while doing  
31 that we'll pick on that point about where we think there's some actions  
32 or offers to circulate further information. Secondly, we will be  
33 discussing the applications at our April Board meeting. That's in late  
34 April. And therefore, the third point is what we now need to consider in  
35 the light of this hearing is how we use the information from this  
36 hearing, the other comments we've received, and whether there's any  
37 further information we need and indeed whether there's any further  
38 analysis we want to share with all of you. It would be over the next few  
39 weeks. I think this is now about the path to get to that April Board  
40 discussion. And apart from that all I wanted to do was to say thank  
41 you very much indeed for attending. And particularly and genuinely  
42 thank you very much for the constructive way in which people have  
43 contributed to this session to date. It's been a long and hard session  
44 but I think it's been very productive. Thank you very much indeed.  
45  
46 VTEC: Excuse me. Sorry. I'd just like to make a couple of points in respect of  
47 process going forward, just following on from your helpful comments

1 just now. Certainly from VTEC's perspective, we've really welcomed  
2 the opportunity today to participate in the stakeholder meeting and  
3 have found it incredibly useful. And just touching on the points you've  
4 made just now about process going forward. It's obviously very  
5 important from VTEC's and the applicants' perspective that we have a  
6 fair and transparent process that leads to the best outcome for the  
7 ECML route and from that perspective we're very conscious that  
8 you've got three independent reports in front of you which take quite  
9 divergent views on key issues. And we're very conscious it's of course  
10 for the ORR to understand the differences between those reports and  
11 to re-appraise the reports if necessary. And then take its own rational,  
12 independent decision as to what the right outcome could be, but  
13 certainly from VTEC's perspective we would like to emphasise the  
14 need to ensure sufficient time from our perspective to make further  
15 representations to you and in particular on the particularly fundamental  
16 divergences between the experts, if there is an opportunity to put to us  
17 where you're coming out in terms of provisional thinking and  
18 conclusions, that would be much appreciated, just to ensure that we  
19 can make appropriate representations and ensure that you have all  
20 relevant available evidence available to you to take the best decision  
21 possible.  
22

23 THE CHAIR: Okay, thank you. That leans a bit to the point I was making about  
24 what further analysis we want to share with the parties. I do  
25 understand that point and we will think about how best to do that.  
26

27 DFT: Could I just ask a process point? Is it your intention at the moment to  
28 invite the Board in April to take a decision? And if so, that doesn't  
29 leave a huge amount of time if there are further iterations following the  
30 hearing. You may not be able to say exactly what your approach is  
31 likely to be to the April Board but I just want to get a sense as to what  
32 you're thinking.  
33

34 THE CHAIR: No, I was consciously not saying because my final point was about  
35 what's the path to that discussion and how much more we would need  
36 to do before that discussion. So, there will be discussion at the Board  
37 but in terms of whether we invite the Board to make – or making a  
38 recommendation to the Board, or whatever – we haven't decided that.  
39 I think it goes back to this point about: To what extent have we brought  
40 all the information together? And that's what I really do want to reflect  
41 on as a result of this hearing.  
42

43 DFT: Thank you.

44  
45 THE CHAIR: Thank you all very much indeed. Thank you.  
46  
47

**The meeting concluded at 3.33 p.m.**